

MID PENN BANCORP INC  
Form 10-Q  
August 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	25-1666413 (I.R.S. Employer Identification Number)
349 Union Street  Millersburg, Pennsylvania (Address of Principal Executive Offices)	17061 (Zip Code)

Registrant's telephone number, including area code 1.866.642.7736

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check One).

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
----------------------------	----------------------	--------------------------	------------------------------	----------------------------

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of August 7, 2018, the registrant had 8,450,893 shares of common stock outstanding.

---

MID PENN BANCORP, INC.

FORM 10-Q

TABLE OF CONTENTS

<u>PART 1 – FINANCIAL INFORMATION</u>	2
<u>Item 1 – Financial Statements</u>	2
<u>Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017 (Unaudited)</u>	2
<u>Consolidated Statements of Income for the Three and Six Months Ended June 30, 2018 and June 30, 2017 (Unaudited)</u>	3
<u>Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2018 and June 30, 2017 (Unaudited)</u>	4
<u>Consolidated Statements of Changes in Shareholders’ Equity for the Six Months Ended June 30, 2018 and June 30, 2017 (Unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and June 30, 2017 (Unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	8
<u>Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	38
<u>Item 3 – Quantitative and Qualitative Disclosures about Market Risk</u>	55
<u>Item 4 – Controls and Procedures</u>	55
<u>PART II – OTHER INFORMATION</u>	56
<u>Item 1 – Legal Proceedings</u>	56
<u>Item 1A – Risk Factors</u>	56
<u>Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds</u>	57
<u>Item 3 – Defaults upon Senior Securities</u>	57
<u>Item 4 – Mine Safety Disclosures</u>	57
<u>Item 5 – Other Information</u>	57
<u>Item 6 – Exhibits</u>	57

Signatures

Unless the context otherwise requires, the terms “Mid Penn”, “we”, “us”, and “our” refer to Mid Penn Bancorp, Inc. and its consolidated subsidiaries.

1

---

MID PENN BANCORP, INC.

## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Cash and due from banks	\$25,436	\$ 19,795
Interest-bearing balances with other financial institutions	4,775	3,028
Federal funds sold	9,196	691
Total cash and cash equivalents	39,407	23,514
Investment securities available for sale, at fair value	111,691	93,465
Investment securities held to maturity, at amortized cost (fair value \$150,016 and \$100,483)	153,321	101,356
Loans held for sale	1,185	1,040
Loans and leases, net of unearned interest	1,036,479	910,404
Less: Allowance for loan and lease losses	(8,189 )	(7,606 )
Net loans and leases	1,028,290	902,798
Bank premises and equipment, net	23,905	16,168
Cash surrender value of life insurance	13,171	13,042
Restricted investment in bank stocks	2,765	4,384
Foreclosed assets held for sale	912	189
Accrued interest receivable	5,372	4,564
Deferred income taxes	2,540	1,888
Goodwill	23,107	3,918
Core deposit and other intangibles, net	4,878	434
Other assets	5,103	3,594
Total Assets	\$1,415,647	\$ 1,170,354
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing demand	\$207,013	\$ 163,714
Interest-bearing demand	349,109	349,241
Money Market	273,215	246,220
Savings	171,845	62,770
Time	235,336	201,623

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Total Deposits	1,236,518	1,023,568
Short-term borrowings	—	34,611
Long-term debt	12,241	12,352
Subordinated debt	17,342	17,338
Accrued interest payable	1,186	645
Other liabilities	6,585	6,137
Total Liabilities	1,273,872	1,094,651
Shareholders' Equity:		
Common stock, par value \$1.00; authorized 10,000,000 shares; 6,124,517 and 4,246,216 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	6,125	4,242
Additional paid-in capital	103,498	40,970
Retained earnings	35,386	32,565
Accumulated other comprehensive loss	(3,234 )	(2,074 )
Total Shareholders' Equity	141,775	75,703
Total Liabilities and Shareholders' Equity	\$1,415,647	\$1,170,354

The accompanying notes are an integral part of these consolidated financial statements.

MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share data)	Three Months		Six Months Ended	
	Ended June 30, 2018	2017	June 30, 2018	2017
<b>INTEREST INCOME</b>				
Interest and fees on loans and leases	\$12,073	\$9,949	\$23,410	\$19,651
Interest on interest-bearing balances	17	5	26	7
Interest on federal funds sold	153	23	321	74
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	884	574	1,636	1,019
State and political subdivision obligations, tax-exempt	517	264	1,059	580
Other securities	76	64	248	107
Total Interest Income	13,720	10,879	26,700	21,438
<b>INTEREST EXPENSE</b>				
Interest on deposits	1,997	1,277	3,777	2,481
Interest on short-term borrowings	—	13	12	13
Interest on long-term and subordinated debt	309	179	619	359
Total Interest Expense	2,306	1,469	4,408	2,853
Net Interest Income	11,414	9,410	22,292	18,585
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>				
Net Interest Income After Provision for Loan and Lease Losses	11,414	9,310	22,167	18,360
<b>NONINTEREST INCOME</b>				
Income from fiduciary activities	286	200	526	396
Service charges on deposits	222	174	425	379
Net gain on sales of investment securities	4	12	102	20
Earnings from cash surrender value of life insurance	65	66	129	131
Mortgage banking income	205	225	361	416
ATM debit card interchange income	326	232	591	456
Merchant services income	93	92	171	166
Net gain on sales of SBA loans	152	157	409	441
Other income	206	204	492	393
Total Noninterest Income	1,559	1,362	3,206	2,798
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	4,542	4,159	9,606	8,389
Occupancy expense, net	870	593	1,667	1,241
Equipment expense	544	370	952	751
Pennsylvania bank shares tax expense	171	160	342	330
FDIC Assessment	93	194	321	388
Legal and professional fees	256	189	480	366
Marketing and advertising expense	230	131	419	238
Software licensing	512	370	1,026	699
Telephone expense	156	133	303	259
Loss on sale or write-down of foreclosed assets	1	6	3	88
Intangible amortization	248	24	496	53

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Merger and acquisition expense	222	14	1,916	224
Other expenses	1,897	1,215	3,394	2,334
Total Noninterest Expense	9,742	7,558	20,925	15,360
INCOME BEFORE PROVISION FOR INCOME TAXES	3,231	3,114	4,448	5,798
Provision for income taxes	452	769	665	1,459
NET INCOME	\$2,779	\$2,345	\$3,783	\$4,339
PER COMMON SHARE DATA:				
Basic and Diluted Earnings Per Common Share	\$0.45	\$0.55	\$0.63	\$1.02
Cash Dividends Paid	\$0.15	\$0.13	\$0.40	\$0.36

The accompanying notes are an integral part of these consolidated financial statements.

3

---



MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(Dollars in thousands)	Three Months Ended June 30,	
	2018	2017
Net income	\$2,779	\$2,345
Other comprehensive (loss) income:		
Unrealized losses arising during the period on available-for-sale securities, net of income taxes of (\$88) and \$763, respectively	(333 )	1,480
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$1) and (\$4), respectively (a)	(3 )	(8 )
Change in defined benefit plans, net of income taxes of \$277 and (\$1), respectively (b)	1,043	(1 )
Total other comprehensive income	707	1,471
Total comprehensive income	\$3,486	\$3,816
(Dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Net income	\$3,783	\$4,339
Other comprehensive (loss) income:		
Unrealized (losses) gains arising during the period on available-for-sale securities, net of income tax impact of (\$564) and \$958, respectively	(2,156)	1,859
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income tax impact of \$(21) and \$(7), respectively (a)	(81 )	(13 )
Change in defined benefit plans, net of income tax impact of \$277 and (\$2), respectively (b)	1,042	(4 )
Total other comprehensive (loss) income	(1,195)	1,842
Total comprehensive income	\$2,588	\$6,181

(a) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate element within total noninterest income.

(b) Amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income as a separate element within total noninterest expense.

The accompanying notes are an integral part of these consolidated financial statements.

## MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

For the Six Months Ended June 30, 2018 and 2017

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, January 1, 2018	\$ 4,242	\$ 40,970	\$ 32,565	\$ (2,074)	\$ 75,703
Impact of adoption of new accounting standard (a)	—	—	(44)	35	(9)
Balance at January 1, 2018, adjusted	4,242	40,970	32,521	(2,039)	75,694
Net income	—	—	3,783	—	3,783
Total other comprehensive loss, net of taxes	—	—	—	(1,195)	(1,195)
Common stock issued to Scottsdale shareholders					
(1,878,827 shares) (b)	1,879	62,302	—	—	64,181
Employee Stock Purchase Plan (1,655 shares)	2	54	—	—	56
Director Stock Purchase Plan (1,819 shares)	2	59	—	—	61
Common stock dividends declared	—	—	(918)	—	(918)
Restricted stock activity	—	113	—	—	113
Balance, June 30, 2018	\$ 6,125	\$ 103,498	\$ 35,386	\$ (3,234)	\$ 141,775
Balance, January 1, 2017	\$ 4,233	\$ 40,688	\$ 28,399	\$ (2,853)	\$ 70,467
Net income	—	—	4,339	—	4,339
Total other comprehensive income, net of taxes	—	—	—	1,842	1,842
Employee Stock Purchase Plan (1,940 shares)	2	50	—	—	52
Common stock dividends declared	—	—	(1,101)	—	(1,101)
Restricted stock activity	—	37	—	—	37
Balance, June 30, 2017	\$ 4,235	\$ 40,775	\$ 31,637	\$ (1,011)	\$ 75,636

(a) Represents the impact of adopting Accounting Standard Update ASU 2016-01. See Note 3 to the consolidated financial statements for more information.

(b) Shares issued on January 8, 2018 as a result of the acquisition of The Scottsdale Bank & Trust Company ("Scottsdale"). See Note 2 to the consolidated financial statements for more information.

The accompanying notes are an integral part of these consolidated financial statements.



MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)	Six Months Ended	
	June 30, 2018	2017
<b>Operating Activities:</b>		
Net Income	\$3,783	\$4,339
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	125	225
Depreciation	1,000	715
Amortization of intangibles	496	53
Net amortization (accretion) of security discounts/premiums	451	(742 )
Gain on sales of investment securities	(102 )	(20 )
Earnings on cash surrender value of life insurance	(129 )	(131 )
Mortgage loans originated for sale	(22,596 )	(23,234 )
Proceeds from sales of mortgage loans originated for sale	22,812	23,240
Gain on sale of mortgage loans	(361 )	(416 )
SBA loans originated for sale	(5,056 )	(5,605 )
Proceeds from sales of SBA loans originated for sale	5,465	6,046
Gain on sale of SBA loans	(409 )	(441 )
Loss on disposal of property, plant, and equipment	64	26
Loss on sale or write-down of foreclosed assets	3	88
Stock compensation expense	113	37
Deferred income tax benefit (expense)	1,981	(65 )
Decrease (increase) in accrued interest receivable	181	(63 )
Increase in other assets	(1,242 )	(193 )
Increase in accrued interest payable	525	273
(Decrease) increase in other liabilities	(2,186 )	381
Net Cash Provided By Operating Activities	4,918	4,513
<b>Investing Activities:</b>		
Proceeds from the sale of available-for-sale securities	102,816	37,667
Proceeds from the maturity or call of available-for-sale securities	5,654	3,579
Purchases of available-for-sale securities	(21,533 )	(13,827 )
Proceeds from the maturity or call of held-to-maturity securities	11,625	—
Purchases of held-to-maturity securities	(57,850 )	(72,684 )
Net cash received from acquisition	65,025	—
Redemptions (purchases) of restricted investment in bank stock	1,716	(1,542 )
Net increase in loans and leases	(55,732 )	(48,078 )
Proceeds from the sale of bank premises and equipment held for sale	—	2,201
Purchases of bank premises and equipment	(7,305 )	(1,164 )
Proceeds from the sale of foreclosed assets	169	136
Net Cash Provided by (Used In) Investing Activities	44,585	(93,712 )
<b>Financing Activities:</b>		
Net increase in deposits	2,969	52,095

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Net (decrease) increase in short-term borrowings	(34,611 )	21,468
Common stock dividends paid	(1,978 )	(1,101 )
Employee Stock Purchase Plan	56	52
Director Stock Purchase Plan	61	—
Long-term debt repayment	(107 )	(109 )
Net Cash (Used In) Provided By Financing Activities	(33,610 )	72,405
Net increase (decrease) in cash and cash equivalents	15,893	(16,794)
Cash and cash equivalents, beginning of period	23,514	45,973
Cash and cash equivalents, end of period	\$39,407	\$29,179

MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)

(Dollars in thousands)	Six Months	
	Ended June 30,	
	2018	2017
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest paid	\$3,867	\$2,580
Income taxes paid	\$1,425	\$2,190
<b>Supplemental Noncash Disclosures:</b>		
Loan transfers to foreclosed assets held for sale	\$884	\$—

## Assets, Liabilities, and Equity in Connection with Merger:

(Dollars in thousands)	Six Months	
	Ended June 30,	
	2018	2017
<b>Assets Acquired:</b>		
Securities	\$114,039	\$—
Loans	70,769	—
Restricted stock	97	—
Property and equipment	1,496	—
Foreclosed assets	11	—
Deferred income taxes	1,050	—
Accrued interest receivable	989	—
Core deposit intangible	4,940	—
Other assets	266	—
	\$193,657	\$—
<b>Liabilities Assumed:</b>		
Deposits	\$209,981	\$—
Accrued interest payable	16	—
Other liabilities	3,693	—
	\$213,690	\$—

The accompanying notes are an integral part of these consolidated financial statements.





MID PENN BANCORP, INC.

(1)Basis of Presentation

The accompanying consolidated financial statements include the accounts of Mid Penn Bancorp, Inc. (the “Company”) and its wholly-owned subsidiary, Mid Penn Bank (the “Bank”). All material intercompany accounts and transactions have been eliminated in consolidation.

Certain information and disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Mid Penn believes the information presented is not misleading and the disclosures are adequate. For comparative purposes, the June 30, 2017 and December 31, 2017 balances have been reclassified, when, and if necessary, to conform to the 2018 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. In the opinion of management, all adjustments necessary for fair presentation of the periods presented have been reflected in the accompanying consolidated financial statements. All such adjustments are of a normal, recurring nature. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

On January 8, 2018, Mid Penn completed its acquisition of The Scottdale Bank & Trust Company (“Scottdale”), a Pennsylvania bank and trust company, through the merger of Scottdale with and into Mid Penn Bank pursuant to the previously announced Agreement and Plan of Merger, dated as of March 29, 2017, among Mid Penn, Mid Penn Bank and Scottdale. Refer to Note 2, Merger, as well as the Company’s Current Report on Form 8-K filed on January 8, 2018, for more information. The comparability of the financial condition and results of operations as of and for the three and six months ended June 30, 2018 and 2017, in general, have been impacted by the acquisition of Scottdale.

On January 16, 2018, Mid Penn entered into an Agreement and Plan of Merger with First Priority Financial Corp. (“First Priority”) pursuant to which First Priority would merge with and into Mid Penn (the “Merger”), with Mid Penn being the surviving corporation in the Merger. On July 31, 2018, Mid Penn completed its acquisition of First Priority. Refer to Note 14, Subsequent Events, as well as the Company’s Current Report on Form 8-K filed on August 1, 2018, for more information.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2018, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

(2)Merger

On January 8, 2018, The Scottdale Bank & Trust Company (“Scottdale”) merged with and into Mid Penn Bank, with Mid Penn Bank continuing as the surviving entity.

Pursuant to the Merger Agreement, each share of Scottdale common stock issued and outstanding immediately prior to January 8, 2018 converted into the right to receive (i) \$1,166 in cash without interest or (ii) 38.88 shares of Mid

Penn common stock. As a result, Mid Penn issued 1,878,827 shares of Mid Penn common stock with an acquisition date fair value of approximately \$64,181,000, based on the closing stock price of Mid Penn's common stock on January 8, 2018 of \$34.16, and cash of \$2,792,000. Including an insignificant amount of cash paid in lieu of fractional shares, the fair value of total consideration paid was \$66,973,000.

The assets and liabilities of Scottdale were recorded on the consolidated balance sheet of the Company at their estimated fair value as of January 8, 2018, and their results of operations have been included in the consolidated income statement of the Company since such date. Scottdale has been fully integrated into Mid Penn, therefore the amount of revenue and earnings of Scottdale included in the consolidated

income statement since the acquisition date is impracticable to provide.

Included in the purchase price was goodwill of \$19,189,000 and a core deposit intangible of \$4,940,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense related to the Scottdale acquisition for the five years beginning 2018 through 2022 is estimated to be \$898,000, \$808,000, \$719,000, \$629,000, and \$539,000 per year, respectively, and \$1,347,000 in total for the five years after 2022.

MID PENN BANCORP, INC.

The allocation of the purchase price is as follows:

(Dollars in thousands)

Assets acquired:	
Cash and cash equivalents	\$67,817
Investment securities	114,039
Restricted stock	97
Loans	70,769
Goodwill	19,189
Core deposit intangible	4,940
Premises and equipment	1,496
Foreclosed assets	11
Deferred income taxes	1,050
Accrued interest receivable	989
Other assets	266
Total assets acquired	280,663
Liabilities assumed:	
Deposits	209,981
Accrued interest payable	16
Other liabilities	3,693
Total liabilities assumed	213,690
Consideration paid	\$66,973
Cash paid	\$2,792
Fair value of common stock issued	64,181

Accounting Standards Codification (“ASC”) Topic 805, Business Combinations, allows for adjustments to goodwill for a period of up to one year after the merger date for information that becomes available that reflects circumstances at the merger date. The goodwill recorded related to the Scottsdale acquisition was adjusted in the second quarter of 2018 by \$579,000, primarily to reflect updated acquisition date deferred tax asset amounts as a substantial portion of the final tax return preparation for Scottsdale was completed by June 30, 2018. The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities and equity assumed.

(Dollars in thousands)

Total purchase price	\$66,973
Net assets acquired:	
Cash and cash equivalents	67,817
Investment securities	114,039
Restricted stock	97

Loans	70,769
Core deposit intangible	4,940
Premises and equipment	1,496
Foreclosed assets	11
Deferred income taxes	1,050
Accrued interest receivable	989
Other assets	266
Deposits	(209,981)
Accrued interest payable	(16 )
Other liabilities	(3,693 )
	47,784
Goodwill	\$19,189

In general, factors contributing to goodwill recognized as a result of the Scottsdale acquisition include expected cost savings from combined operations, opportunities to expand into several new markets, and growth and profitability potential from the repositioning of short-term investments into higher-yielding loans. The goodwill acquired as a result of the Scottsdale acquisition is not tax deductible.

## MID PENN BANCORP, INC.

The fair value of the financial assets acquired included loans receivable with a net amortized cost basis of \$70,769,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired.

(Dollars in thousands)

Gross amortized cost basis at January 8, 2018	\$71,809
Market rate adjustment	601
Credit fair value adjustment on pools of homogeneous loans	(995 )
Credit fair value adjustment on impaired loans	(646 )
Fair value of purchased loans at January 8, 2018	\$70,769

The market rate adjustment represents the movement in market interest rates, irrespective of credit adjustments, compared to the contractual rates of the acquired loans. The credit adjustment made on pools of homogeneous loans represents the changes in credit quality of the underlying borrowers from loan inception to the acquisition date. The credit adjustment on impaired loans is derived in accordance with ASC 310-30-30 and represents the portion of the loan balance that has been deemed uncollectible based on our expectations of future cash flows for each respective loan.

The information about the acquired Scottsdale impaired loan portfolio as of January 8, 2018 is as follows:

(Dollars in thousands)

Contractually required principal and interest at acquisition	\$2,586
Contractual cash flows not expected to be collected (nonaccretable discount)	(1,010)
Expected cash flows at acquisition	1,576
Interest component of expected cash flows (accretable discount)	(305 )
Fair value of acquired loans	\$1,271

The following table presents pro forma information as if the merger between Mid Penn Bank and Scottsdale had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn Bank merged with Scottsdale at the beginning of 2017. The supplemental pro forma earnings for six months ended June 30, 2018 exclude both (i) adjustments to estimate the eight day impact of Scottsdale due to immateriality and impracticality and (ii) \$1,262,000 of merger related costs incurred in 2018 related to the Scottsdale acquisition, which included approximately \$518,000 of severance and retention bonus expenses. The results for the six months ended June 30, 2017 were adjusted to include \$1,262,000 of merger related costs which would have been incurred if the merger had been completed January 1, 2017. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other factors.

(Dollars in thousands, except per share data)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Net interest income after loan loss provision	\$11,414	\$10,883	\$22,167	\$1,448
Noninterest income	1,559	1,486	3,206	1,585
Noninterest expense	9,753	10,275	19,663	2,544
Net income	2,768	1,529	4,831	357
Net income per common share	0.45	0.25	0.79	0.06

### (3) Investment Securities

Securities to be held for indefinite periods, but not intended to be held to maturity, are classified as available-for-sale and carried at fair value. Securities held for indefinite periods include securities that management intends to use as part of its asset and liability management strategy and that may be sold in response to liquidity needs, changes in interest rates, resultant prepayment risk, pledging requirements, and other factors related to effective portfolio management. Securities to be held to maturity are carried at amortized cost.

For available-for-sale debt securities, realized gains and losses on dispositions are based on the net proceeds and the amortized cost of the securities sold, using the specific identification method. Unrealized gains and losses on debt securities are based on the difference between the amortized cost and fair value of each security as of the respective reporting date. Unrealized gains and losses are credited or charged to other comprehensive income, whereas realized gains and losses flow through Mid Penn's consolidated statements of income for the respective period.

## MID PENN BANCORP, INC.

ASC Topic 320, Investments – Debt and Equity Securities, clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess, in addition to the credit condition of the underlying issuer, whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment.

In instances when a determination is made that other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, this guidance changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Mid Penn had no securities considered by management to be other-than-temporarily impaired as of June 30, 2018, December 31, 2017, or June 30, 2017, and did not record any securities impairment charges in the respective periods ended on these dates. Mid Penn does not consider the securities with unrealized losses on the respective dates to be other-than-temporarily impaired as the unrealized losses were deemed to relate to changes in interest rates, and not erosion of credit quality.

Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value within other assets on the balance sheet, with realized and unrealized gains and losses reported in other expense on the income statement. For periods prior to January 1, 2018, equity securities were classified as available-for-sale and stated at fair value within investment securities available-for-sale on the balance sheet, with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. Equity securities without readily determinable fair values are recorded at cost less any impairment.

The amortized cost, fair value, and unrealized gains and losses on investment securities at June 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>June 30, 2018</b>				
Available-for-sale debt securities:				
U.S. Treasury and U.S. government agencies	\$ 40,597	\$ —	\$ 2,257	\$ 38,340
Mortgage-backed U.S. government agencies	43,713	1	1,288	42,426
State and political subdivision obligations	31,551	3	1,980	29,574
Corporate debt securities	1,350	1	—	1,351
Total available-for-sale debt securities	117,211	5	5,525	111,691
Held-to-maturity debt securities:				
U.S. Treasury and U.S. government agencies	10,985	—	201	10,784
Mortgage-backed U.S. government agencies	66,512	4	1,649	64,867
State and political subdivision obligations	75,824	57	1,516	74,365

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Total held-to-maturity debt securities	153,321	61	3,366	150,016
<b>Total</b>	<b>\$ 270,532</b>	<b>\$ 66</b>	<b>\$ 8,891</b>	<b>\$ 261,707</b>

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2017				
Available-for-sale debt securities:				
U.S. Treasury and U.S. government agencies	\$ 40,125	\$ —	\$ 1,395	\$ 38,730
Mortgage-backed U.S. government agencies	26,398	2	569	25,831
State and political subdivision obligations	27,775	7	739	27,043
Corporate debt securities	1,350	5	—	1,355
<b>Total available-for-sale debt securities</b>	<b>95,648</b>	<b>14</b>	<b>2,703</b>	<b>92,959</b>
Available-for-sale equity securities:				
Equity securities	550	—	44	506
<b>Total available-for-sale equity securities</b>	<b>550</b>	<b>—</b>	<b>44</b>	<b>506</b>
Held-to-maturity debt securities:				
U.S. Treasury and U.S. government agencies	10,984	—	90	10,894
Mortgage-backed U.S. government agencies	53,472	—	523	52,949
State and political subdivision obligations	36,900	41	301	36,640
<b>Total held-to-maturity debt securities</b>	<b>101,356</b>	<b>41</b>	<b>914</b>	<b>100,483</b>
<b>Total</b>	<b>\$ 197,554</b>	<b>\$ 55</b>	<b>\$ 3,661</b>	<b>\$ 193,948</b>



## MID PENN BANCORP, INC.

Estimated fair values of debt securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued. Please refer to Note 5, Fair Value Measurement, for more information on the fair value of investment securities.

Equity securities consist of Community Reinvestment Act funds and, as of June 30, 2018 and December 31, 2017, Mid Penn had \$492,000 and \$506,000, respectively, in equity securities recorded at fair value. Prior to January 1, 2018, equity securities were stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. At December 31, 2017, net unrealized gains of \$44,000 had been recognized in accumulated other comprehensive loss. On January 1, 2018, with the adoption of ASU 2016-01, these unrealized gains and losses were reclassified out of accumulated other comprehensive loss and into retained earnings and subsequent changes in fair value are now recognized in net income and the fair value of securities is presented in other assets. No equity securities were sold during the three and six months ended June 30, 2018.

Investment securities having a fair value of \$158,363,000 at June 30, 2018 and \$141,465,000 at December 31, 2017 were pledged to secure public deposits, some trust account holdings, and certain other borrowings.

Gross realized gains and losses on sales of available-for-sale debt securities for the three and six months ended June 30, 2018 and 2017 are shown in the table below.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Realized gains	\$11	\$77	\$111	\$200
Realized losses	(7)	(65)	(9)	(180)
Net gains	\$4	\$12	\$102	\$20

The following tables present gross unrealized losses and fair value of debt security investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
June 30, 2018									
Available-for-sale debt securities:									

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

U.S. Treasury and U.S. government agencies	3	\$4,453	\$ 231	19	\$33,887	\$ 2,026	22	\$38,340	\$ 2,257
Mortgage-backed U.S. government agencies	15	23,474	407	15	18,916	881	30	42,390	1,288
State and political subdivision obligations	15	8,094	356	41	18,486	1,624	56	26,580	1,980
Total temporarily impaired available-for-sale debt securities	33	36,021	994	75	71,289	4,531	108	107,310	5,525
Held-to-maturity debt securities:									
U.S. Treasury and U.S. government agencies	3	8,793	191	1	1,991	10	4	10,784	201
Mortgage-backed U.S. government agencies	37	54,276	1,324	7	8,825	325	44	63,101	1,649
State and political subdivision obligations	134	53,362	1,461	3	1,486	55	137	54,848	1,516
Total temporarily impaired held-to-maturity debt securities	174	116,431	2,976	11	12,302	390	185	128,733	3,366
Total	207	\$152,452	\$ 3,970	86	\$83,591	\$ 4,921	293	\$236,043	\$ 8,891

## MID PENN BANCORP, INC.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
December 31, 2017									
Available-for-sale securities:									
U.S. Treasury and U.S. government agencies	3	\$5,008	\$ 184	18	\$33,722	\$ 1,211	21	\$38,730	\$ 1,395
Mortgage-backed U.S. government agencies	4	5,267	75	15	20,497	494	19	25,764	569
State and political subdivision obligations	11	6,144	102	40	19,091	637	51	25,235	739
Equity securities	0	—	—	1	506	44	1	506	44
Total temporarily impaired available-for-sale securities	18	\$16,419	\$ 361	74	\$73,816	\$ 2,386	92	\$90,235	\$ 2,747
Held-to-maturity securities:									
U.S. Treasury and U.S. government agencies	0	—	—	4	10,894	90	4	10,894	90
Mortgage-backed U.S. government agencies	0	—	—	35	52,949	523	35	52,949	523
State and political subdivision obligations	0	—	—	77	29,976	301	77	29,976	301
Total temporarily impaired held to maturity securities	0	—	—	116	93,819	914	116	93,819	914
Total	18	\$16,419	\$ 361	190	\$167,635	\$ 3,300	208	\$184,054	\$ 3,661

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such additional evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than amortized cost and the financial condition and near term prospects of the issuer. In addition, for debt securities, Mid Penn considers (a) whether management has the intent to sell the security, (b) it is more likely than not that management will be required to sell the security prior to its anticipated recovery, and (c) whether management expects to recover the entire amortized cost basis. For equity securities, management considers the intent and ability to hold securities until recovery of unrealized losses.

The majority of the investment portfolio is comprised of securities issued by U.S. government agencies and state and political subdivision obligations. For the investment securities with an unrealized loss, Mid Penn has concluded that,

based on its analysis, the unrealized losses were primarily caused by the movement of interest rates and not due to an erosion of credit quality of the underlying issuers.

At both June 30, 2018 and December 31, 2017, the majority of available-for-sale securities and held-to-maturity securities in an unrealized loss position were obligations of state and political subdivisions, U.S. Treasury and agency securities, and mortgage-backed U.S. government agencies.

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value as of June 30, 2018.

(Dollars in thousands)	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
June 30, 2018				
Due in 1 year or less	\$1,460	\$1,460	\$2,001	\$1,991
Due after 1 year but within 5 years	18,711	18,050	11,705	11,494
Due after 5 years but within 10 years	43,730	41,041	71,195	69,796
Due after 10 years	9,597	8,714	1,909	1,868
	73,498	69,265	86,810	85,149
Mortgage-backed securities	43,713	42,426	66,511	64,867
	\$117,211	\$111,691	\$153,321	\$150,016

(4) Loans and Allowance for Loan and Lease Losses

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the

MID PENN BANCORP, INC.

unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans, generally being amortized over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loan portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, commercial real estate-construction and lease financing. Consumer loans consist of the following classes: residential mortgage loans, home equity loans and other consumer loans.

For all classes of loans, the accrual of interest generally is discontinued when the contractual payment of principal or interest has become 90 days or more past due, or management has serious doubts about further collectability of principal or interest even though the loan is currently performing. A loan past due 90 days or more may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest is credited to income. Interest received on nonaccrual loans, including impaired loans, is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Nonaccrual loans may be restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally, at least nine consecutive months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

#### Commercial and Industrial

Mid Penn originates commercial and industrial loans. Most of the Bank's commercial and industrial loans have been extended to finance local and regional businesses and include short-term loans to finance machinery and equipment purchases, inventory, and accounts receivable. Commercial loans also involve the extension of revolving credit for a combination of equipment acquisitions and working capital in expanding companies.

The maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Generally, the maximum term on non-mortgage lines of credit is one year. The loan-to-value ratio on such loans and lines of credit generally may not exceed 80 percent of the value of the collateral securing the loan. The Bank's commercial business lending policy includes credit file documentation and analysis of the borrower's character, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of conditions affecting the borrower. Analysis of the borrower's past, present, and future cash flows is also an important aspect of the Bank's current credit analysis. Nonetheless, such loans are believed to carry higher credit risk than other extensions of credit.

Commercial and industrial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself, which, in turn, is likely to be dependent upon the general economic environment. Mid Penn's commercial and industrial loans are usually, but not always, secured by business assets and personal guarantees. However, the collateral securing the loans may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business.

#### Commercial Real Estate and Commercial Real Estate - Construction

Commercial real estate and commercial real estate construction loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. In addition, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

### Residential Mortgage

Mid Penn offers a wide array of residential mortgage loans for both permanent structures and those under construction. The Bank's residential mortgage originations are secured primarily by properties located in its primary market and surrounding areas. Residential mortgage loans have terms up to a maximum of 30 years and with loan-to-value ratios up to 100 percent of the lesser of the appraised value of the security property or the contract price. Private mortgage insurance is generally required in an amount sufficient to reduce the Bank's exposure to at or below the 85 percent loan to value level. Residential mortgage loans generally do not include prepayment penalties.

In underwriting residential mortgage loans, the Bank evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by Mid Penn are appraised by independent fee appraisers. The Bank generally requires borrowers to obtain title insurance and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Bank generally contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property.

The Bank underwrites residential mortgage loans to the standards established by the secondary mortgage market, i.e., Fannie Mae, Ginnie Mae, Freddie Mac, or Pennsylvania Housing Finance Agency standards, with the intention of selling the majority of residential mortgages originated into the secondary market. In the event that the facts and circumstances surrounding a residential mortgage application do not meet all underwriting conditions of the secondary mortgage market, the Bank will evaluate the failed conditions and evaluate the potential

MID PENN BANCORP, INC.

risk of holding the residential mortgage in the Bank's portfolio rather than rejecting the loan request. In the event that the loan is held in the Bank's portfolio, the interest rate on the residential mortgage would be increased to compensate for the added portfolio risk.

Consumer, Including Home Equity

Mid Penn offers a variety of secured consumer loans, including home equity, automobile, and deposit secured loans. In addition, the Bank offers other secured and unsecured consumer loans. Most consumer loans are originated in Mid Penn's primary market and surrounding areas.

The largest component of Mid Penn's consumer loan portfolio consists of fixed rate home equity loans and variable rate home equity lines of credit. Substantially all home equity loans and lines of credit are secured by junior lien mortgages on principal residences. The Bank will lend amounts, which, together with all prior liens, typically may be up to 85 percent of the appraised value of the property securing the loan. Home equity term loans may have maximum terms up to 20 years, while home equity lines of credit generally have maximum terms of five years.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed by the Bank for consumer loans include an application, a determination of the applicant's payment history on other debts, and an assessment of ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market weakens and property values deteriorate.

Allowance for Loan and Lease Losses

The allowance for credit losses ("allowance") consists of (i) the allowance for loan and lease losses, and (ii) the reserve for unfunded lending commitments. The allowance for loan and lease losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet. The reserve for unfunded lending commitments was \$108,000 at June 30, 2018 and \$105,000 at December 31, 2017. The allowance is increased by the provision for loan and lease losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed

uncollectible. Because all identified losses are immediately charged off, no portion of the allowance is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance is maintained at a level considered by management to be adequate to provide for losses that can be reasonably anticipated. Management performs a monthly evaluation of the adequacy of the allowance. The allowance is based on Mid Penn's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan.

The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include changes in economic conditions, fluctuations in loan quality measures, changes in collateral values, changes in the experience of the lending staff and loan review systems, changes in lending policies and procedures (including underwriting standards), changes in the mix and volume of loans originated, the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio, shifting industry or portfolio concentrations, and other relevant factors.



MID PENN BANCORP, INC.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the allowance for loan and lease losses covers several considerations that are not specifically measureable through either the specific and general components. For example, we believe that we could face increasing credit risks and uncertainties, not yet reflected in recent historical losses or qualitative factor assessments, associated with unpredictable changes in economic growth or business conditions in our markets or for certain industries in which we have commercial loan borrowers, or unanticipated stresses to the values of real estate held as collateral. Any or all of these additional issues can adversely affect our borrowers' ability to timely repay their loans. Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, the unallocated component allocation recognizes the inherent imprecision in our allowance for loan and lease loss methodology, or any alternative methodology, for estimating specific and general loan losses, including the unpredictable timing and amounts of charge-offs, the fact that historical loss averages don't necessarily correlate to future loss trends, and unexpected changes to specific-credit or general portfolio future cash flows and collateral values which could negatively impact unimpaired portfolio loss factors.

Mid Penn generally considers a commercial loan (consisting of commercial and industrial, commercial real estate, commercial real estate-construction, and lease financing loan classes) to be impaired when it becomes 90 days or more past due and not in the process of collection or sooner when it is probable that Mid Penn will be unable to collect all contractual principal and interest due. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would generally be considered collateral dependent as the discounted cash flow method would generally indicate no operating income available for evaluating the collateral position; therefore, most impaired loans are deemed to be collateral dependent.

In addition, Mid Penn's rating system assumes any loans classified as nonaccrual, included in the substandard rating, to be impaired, and most of these loans are considered collateral dependent; therefore, most of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as substandard nonaccrual or lower will first have a collateral evaluation completed in accordance with the guidance on impaired loans. Once the collateral evaluation has been completed, a specific allocation of allowance is made based upon the results of the evaluation. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variations in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charging off a residential mortgage loan begins when a loan becomes delinquent for 90 days and is not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans (including home equity loans and other consumer loans) are recommended for charge-off after reaching delinquency of 90 days and the loan is not well-secured or otherwise not probable for collection. The collateral shortfall of the consumer loan is recommended

for charge-off at this point.

As noted above, Mid Penn assesses a specific allocation for commercial loans and commercial real estate loans. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan becomes classified under its internal classification system. A preliminary collateral evaluation, in accordance with the guidance on impaired loans, is prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary, but allows Mid Penn to determine if any potential collateral shortfalls exist.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as practically possible following the credit being classified as substandard nonaccrual. Prior to receipt of the updated real estate valuation, Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however, no allowance recommendation will be made until such time Mid Penn is in receipt of the updated valuation. The Asset Recovery department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no material time lapses noted with the above processes.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary.

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property as soon as practically possible following the credit being placed on nonaccrual status sometimes indicates that the loan

MID PENN BANCORP, INC.

to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 12 months for possible revaluation by an independent third party.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, Mid Penn does not separately identify individual residential mortgage loans, home equity loans and other consumer loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for nine consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Any loans not classified as noted above are rated pass.

In addition, Federal and State regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance and may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

#### Acquired Loans

Loans that Mid Penn acquires in connection with business combinations are recorded at fair value with no carryover of the existing related allowance for loan losses. Fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually

required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. These loans are accounted for under the ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require Mid Penn to evaluate the need for an additional allowance. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which Mid Penn will then reclassify as accretable discount that will be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that meet the specific criteria of ASC 310-30 are individually evaluated each period to analyze expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, Mid Penn establishes an allowance.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that met the criteria for impaired or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if Mid Penn expects to fully collect the new carrying value (i.e. fair value) of the loans. As such, Mid Penn may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

## MID PENN BANCORP, INC.

The classes of the loan portfolio, summarized by the pass rating (net of deferred fees and costs of \$479,000 as of June 30, 2018 and \$464,000 as of December 31, 2017), and the classified ratings of special mention and substandard within Mid Penn's internal risk rating system as of June 30, 2018 and December 31, 2017, are as follows:

(Dollars in thousands)		Special		
June 30, 2018	Pass	Mention	Substandard	Total
Commercial and industrial	\$ 197,102	\$ 2,420	\$ 5,202	\$ 204,724
Commercial real estate	565,517	1,807	8,632	575,956
Commercial real estate - construction	82,323	—	367	82,690
Lease financing	153	—	—	153
Residential mortgage	118,779	262	1,219	120,260
Home equity	47,732	4	79	47,815
Consumer	4,881	—	—	4,881
	\$ 1,016,487	\$ 4,493	\$ 15,499	\$ 1,036,479

(Dollars in thousands)		Special		
December 31, 2017	Pass	Mention	Substandard	Total
Commercial and industrial	\$ 182,168	\$ 453	\$ 5,412	\$ 188,033
Commercial real estate	505,397	1,435	8,180	515,012
Commercial real estate - construction	61,667	182	487	62,336
Lease financing	229	—	—	229
Residential mortgage	97,814	157	1,062	99,033
Home equity	41,479	105	309	41,893
Consumer	3,868	—	—	3,868
	\$ 892,622	\$ 2,332	\$ 15,450	\$ 910,404

Mid Penn had no loans classified as doubtful as of June 30, 2018 and December 31, 2017.

## MID PENN BANCORP, INC.

Impaired loans by loan portfolio class as of June 30, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	June 30, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no related allowance recorded:</b>						
Commercial and industrial	\$—	\$—	\$—	\$—	\$ 13	\$—
Commercial real estate	1,711	2,357	—	3,424	4,056	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	728	852	—	760	877	—
Home equity	8	107	—	260	295	—
Consumer	—	—	—	—	—	—
<b>With no related allowance recorded and acquired with credit deterioration:</b>						
Commercial and industrial	\$23	\$ 23	\$—	\$—	\$—	\$—
Commercial real estate	1,466	1,466	—	555	555	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	493	493	—	306	306	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
<b>With an allowance recorded:</b>						
Commercial and industrial	\$4,324	\$ 4,410	\$ 282	\$4,434	\$ 4,460	\$ 136
Commercial real estate	550	602	238	1,423	1,589	293
Commercial real estate - construction	367	370	54	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
<b>Total Impaired Loans:</b>						
Commercial and industrial	\$4,347	\$ 4,433	\$ 282	\$4,434	\$ 4,473	\$ 136
Commercial real estate	3,727	4,425	238	5,402	6,200	293
Commercial real estate - construction	367	370	54	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	1,221	1,345	—	1,066	1,183	—
Home equity	8	107	—	260	295	—
Consumer	—	—	—	—	—	—

## MID PENN BANCORP, INC.

The average recorded investment of impaired loans and related interest income recognized for the three and six months ended June 30, 2018 and 2017 are summarized as follows:

(Dollars in thousands)	Three Months Ended			
	June 30, 2018		June 30, 2017	
	Average Interest Recorded Investment	Average Interest Recognized	Average Interest Recorded Investment	Average Interest Recognized
<b>With no related allowance recorded:</b>				
Commercial and industrial	\$—	\$ —	\$36	\$ —
Commercial real estate	2,650	3	644	110
Commercial real estate - construction	—	—	473	—
Lease financing	—	—	—	—
Residential mortgage	699	7	860	7
Home equity	95	—	90	—
Consumer	—	—	—	—
<b>With no related allowance recorded and acquired with credit deterioration:</b>				
Commercial and industrial	\$23	\$ —	\$—	\$ —
Commercial real estate	1,455	7	644	110
Commercial real estate - construction	—	—	326	2
Lease financing	—	—	—	—
Residential mortgage	639	—	—	—
Home equity	—	—	—	—
Consumer	—	—	—	—
<b>With an allowance recorded:</b>				
Commercial and industrial	\$4,349	\$ —	\$—	\$ —
Commercial real estate	1,029	—	2,792	—
Commercial real estate - construction	367	—	240	—
Lease financing	—	—	—	—
Residential mortgage	—	—	66	—
Home equity	—	—	—	—
Consumer	—	—	—	—
<b>Total Impaired Loans:</b>				
Commercial and industrial	\$4,372	\$ —	\$36	\$ —
Commercial real estate	5,134	10	4,080	220
Commercial real estate - construction	367	—	1,039	2
Lease financing	—	—	—	—
Residential mortgage	1,338	7	926	7
Home equity	95	—	90	—
Consumer	—	—	—	—





## MID PENN BANCORP, INC.

(Dollars in thousands)	Six Months Ended		June 30, 2017	
	June 30, 2018	Average Interest Recorded Income Recognized	June 30, 2017	Average Interest Recorded Income Recognized
<b>With no related allowance recorded:</b>				
Commercial and industrial	\$—	\$ —	\$18	\$ —
Commercial real estate	2,306	3	524	279
Commercial real estate - construction	17	—	313	—
Lease financing	—	—	—	—
Residential mortgage	796	14	843	18
Home equity	208	—	101	2
Consumer	—	—	—	—
<b>With no related allowance recorded and acquired with credit deterioration:</b>				
Commercial and industrial	\$20	\$ —	\$—	\$ —
Commercial real estate	2,001	14	738	110
Commercial real estate - construction	—	—	—	—
Lease financing	—	—	—	—
Residential mortgage	1,086	—	350	—
Home equity	—	—	—	—
Consumer	—	—	—	—
<b>With an allowance recorded:</b>				
Commercial and industrial	\$3,519	\$ —	\$—	\$ —
Commercial real estate	1,367	—	2,660	—
Commercial real estate - construction	366	—	144	—
Lease financing	—	—	—	—
Residential mortgage	—	—	40	—
Home equity	—	—	—	—
Consumer	—	—	—	—
<b>Total Impaired Loans:</b>				
Commercial and industrial	\$3,539	\$ —	\$18	\$ —
Commercial real estate	5,674	17	3,922	389
Commercial real estate - construction	383	—	457	—
Lease financing	—	—	—	—
Residential mortgage	1,882	14	1,233	18
Home equity	208	—	101	2
Consumer	—	—	—	—

Nonaccrual loans by loan portfolio class as of June 30, 2018 and December 31, 2017 are summarized as follows:

	June 30, 2018	December 31, 2017
(Dollars in thousands)		
Commercial and industrial	\$ 4,347	\$ 4,434
Commercial real estate	3,215	4,902
Commercial real estate - construction	367	487
Residential mortgage	675	492
Home equity	8	260
	\$ 8,612	\$ 10,575

## MID PENN BANCORP, INC.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. As of June 30, 2018 and December 31, 2017 Mid Penn had no accruing loans past due greater than 90 days. The classes of the loan portfolio summarized by the past due status as of June 30, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
June 30, 2018						
Commercial and industrial	\$193	\$5	\$4,324	\$4,522	\$200,179	\$204,701
Commercial real estate	757	1,468	276	2,501	571,989	574,490
Commercial real estate - construction	859	-	367	1,226	81,464	82,690
Lease financing	-	-	-	-	153	153
Residential mortgage	183	62	164	409	119,358	119,767
Home equity	35	-	-	35	47,780	47,815
Consumer	-	9	-	9	4,872	4,881
Loans acquired with credit deterioration:						
Commercial and industrial	-	23	-	23	-	23
Commercial real estate	-	25	901	926	540	1,466
Commercial real estate - construction	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
Residential mortgage	20	10	198	228	265	493
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	\$2,047	\$1,602	\$6,230	\$9,879	\$1,026,600	\$1,036,479

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
December 31, 2017						
Commercial and industrial	\$4,439	\$16	\$-	\$4,455	\$183,578	\$188,033
Commercial real estate	-	-	3,669	3,669	510,788	514,457
Commercial real estate - construction	-	-	487	487	61,849	62,336
Lease financing	-	-	-	-	229	229
Residential mortgage	310	467	177	954	97,773	98,727
Home equity	54	98	250	402	41,491	41,893
Consumer	3	-	-	3	3,865	3,868
Loans acquired with credit deterioration:						
Commercial and industrial	-	-	-	-	-	-
Commercial real estate	500	-	55	555	-	555
Commercial real estate - construction	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
Residential mortgage	-	31	193	224	82	306

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	\$5,306	\$ 612	\$4,831	\$10,749	\$899,655	\$ 910,404

22

---

## MID PENN BANCORP, INC.

The following tables summarize the allowance and recorded investments in loans receivable.

(Dollars in thousands)

As of, and for the

three months ended,	Commercial								Unallocated	Total
	Commercial and industrial	Commercial real estate	Commercial estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated		
June 30, 2018										
Allowance for loan and lease losses:										
Beginning balance,										
April 1, 2018	\$ 1,977	\$ 4,653	\$ 183	\$ -	\$ 452	\$ 391	\$ 4	\$ 6		\$7,666
Charge-offs	(129)	-	(40)	-	(3)	(91)	(4)	-		(267)
Recoveries	-	788	-	-	-	-	2	-		790
Provisions	272	(718)	3	-	(8)	120	2	329		-
Ending balance,										
June 30, 2018	\$ 2,120	\$ 4,723	\$ 146	\$ -	\$ 441	\$ 420	\$ 4	\$ 335		\$8,189

(Dollars in thousands)

As of, and for the

six months ended,	Commercial								Unallocated	Total
	Commercial and industrial	Commercial real estate	Commercial estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated		
June 30, 2018										
Allowance for loan and lease losses:										
Beginning balance,										
January 1, 2018	\$ 1,795	\$ 4,435	\$ 178	\$ -	\$ 428	\$ 423	\$ 3	\$ 344		\$7,606
Charge-offs	(129)	-	(40)	-	(5)	(167)	(10)	-		(351)
Recoveries	-	805	-	-	-	-	4	-		809
Provisions	454	(517)	8	-	18	164	7	(9)		125
Ending balance,										
June 30, 2018	2,120	4,723	146	-	441	420	4	335		8,189
Individually evaluated for impairment	282	238	54	-	-	-	-	-		574
Ending balance:										
Collectively evaluated for impairment	\$ 1,838	\$ 4,485	\$ 92	\$ -	\$ 441	\$ 420	\$ 4	\$ 335		\$7,615
Loans receivables:										
Ending balance	\$ 204,728	\$ 575,955	\$ 82,690	\$ 153	\$ 120,260	\$ 47,815	\$ 4,881	\$ -		\$1,036,479
Ending balance: Individually evaluated for impairment	4,324	2,261	367	-	728	8	-	-		7,688
Ending balance:										
Acquired with credit deterioration	23	1,466	-	-	493	-	-	-		1,982
Ending balance: Collectively evaluated for impairment	\$ 200,377	\$ 572,229	\$ 82,323	\$ 153	\$ 119,039	\$ 47,807	\$ 4,881	\$ -		\$1,026,809

23

## MID PENN BANCORP, INC.

(Dollars in thousands)

	Commercial and industrial		Commercial real estate construction		Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
December 31, 2017	\$ 1,795	\$ 4,435	\$ 178	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,606	
Beginning balance, January 1, 2017	\$ 1,795	\$ 4,435	\$ 178	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,606	
Ending balance: Individually evaluated for impairment	136	293	100	-	-	-	-	-	529	
Ending balance: Collectively evaluated for impairment	\$ 1,659	\$ 4,142	\$ 78	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,077	
Loans receivable: Beginning balance, January 1, 2017	\$ 188,033	\$ 515,012	\$ 62,336	\$ 229	\$ 99,033	\$ 41,893	3,868	\$ -	\$ 910,404	
Ending balance: Individually evaluated for impairment	4,434	4,847	487	-	760	260	-	-	10,788	
Ending balance: Acquired with credit deterioration	-	555	-	-	306	-	-	-	861	
Ending balance:										

Collectively  
evaluated

for  
impairment \$ 183,599\$ 509,610\$ 61,849\$ 229 \$ 97,967\$ 41,633\$ 3,868 \$ - \$898,755  
24

---

## MID PENN BANCORP, INC.

(Dollars  
in  
thousands)  
As of, and  
for the

three  
months  
ended,

	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
June 30, 2017	\$ 1,630	\$ 4,715	\$ 101	\$ 1	\$ 532	\$ 364	\$ 3	\$ 274	\$ 7,620
Allowance for loan and lease losses:									
Beginning balance, April 1, 2017	\$ 1,630	\$ 4,715	\$ 101	\$ 1	\$ 532	\$ 364	\$ 3	\$ 274	\$ 7,620
Charge-offs	-	(30 )	-	-	-	-	(10 )	-	(40 )
Recoveries	3	22	-	-	2	5	1	-	33
Provisions	(5 )	274	39	-	5	35	10	(258)	100
Ending balance, June 30, 2017	\$ 1,628	\$ 4,981	\$ 140	\$ 1	\$ 539	\$ 404	\$ 4	\$ 16	\$ 7,713

(Dollars  
in  
thousands)  
As of, and  
for the

six  
months  
ended,

	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
June 30, 2017	\$ 1,580	\$ 4,323	\$ 144	\$ 1	\$ 541	\$ 379	\$ 3	\$ 212	\$ 7,183
Allowance for loan and lease losses:									
Beginning balance, January 1, 2017	\$ 1,580	\$ 4,323	\$ 144	\$ 1	\$ 541	\$ 379	\$ 3	\$ 212	\$ 7,183



Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Charge-offs	(12 )	(30 )	-	-	(18 )	-	(16 )	-	(76 )
Recoveries	7	361	-	-	4	5	4	-	381
Provisions	53	327	(4 )	-	12	20	13	(196)	225
Ending balance, June 30, 2017	1,628	4,981	140	1	539	404	4	16	7,713
Ending balance: Individually evaluated for impairment	-	893	70	-	66	-	-	-	1,029
Ending balance: Collectively evaluated for impairment	\$ 1,628	\$ 4,088	\$ 70	\$ 1	\$ 473	\$ 404	\$ 4	\$ 16	\$ 6,684

Loans receivables:									
Ending balance	\$ 181,368	\$ 482,141	\$ 53,305	\$ 307	\$ 102,637	\$ 38,671	\$ 3,878	-	\$ 862,307
Ending balance: Individually evaluated for impairment	-	3,651	571	-	968	327	-	-	5,517
Ending balance: Acquired with credit deterioration	-	573	-	-	324	-	-	-	897
Ending balance: Collectively evaluated for impairment	\$ 181,368	\$ 477,917	\$ 52,734	\$ 307	\$ 101,345	\$ 38,344	\$ 3,878	-	\$ 855,893



## MID PENN BANCORP, INC.

The recorded investments in troubled debt restructured loans at June 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)	Pre-Modification	Post-Modification	
	Outstanding	Outstanding	
	Recorded	Recorded	Recorded
	Investment	Investment	Investment
June 30, 2018			
Commercial and industrial	\$ 4,110	\$ 4,460	\$ 4,324
Commercial real estate	2,670	2,571	1,984
Residential mortgage	677	675	528
Home equity	14	14	3
	\$ 7,471	\$ 7,720	\$ 6,839

(Dollars in thousands)	Pre-Modification	Post-Modification	
	Outstanding	Outstanding	
	Recorded	Recorded	Recorded
	Investment	Investment	Investment
December 31, 2017			
Commercial and industrial	\$ 4,110	\$ 4,460	\$ 4,434
Commercial real estate	5,735	5,581	4,593
Residential mortgage	677	675	540
Home equity	14	14	4
	\$ 10,536	\$ 10,730	\$ 9,571

Mid Penn entered into forbearance or modification agreements on all loans currently classified as troubled debt restructures and all of these agreements have resulted in additional principal repayment. The terms of these forbearance agreements vary whereby principal payments have been decreased, interest rates have been reduced and/or the loan will be repaid as collateral is sold.

Mid Penn had troubled debt restructured loans at June 30, 2018 totaling \$6,839,000, and included four loans totaling \$531,000 representing accruing impaired loans to unrelated borrowers in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling \$528,000 and one loan being an accruing impaired home equity loan of \$3,000. The remaining \$6,308,000 of troubled debt restructurings is attributable to nine loans among five relationships which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$5,747,000 of the total \$6,308,000 in nonaccrual impaired troubled debt restructured loans.

At December 31, 2017, Mid Penn's troubled debt restructured loans totaled \$9,571,000, and included four loans totaling \$544,000 representing accruing impaired loans in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling \$540,000, and one loan being an accruing impaired home equity loan of \$4,000. The remaining \$9,027,000 of troubled debt restructured loans is attributable to fifteen loans among seven relationships, which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$7,284,000 of the \$9,027,000 in nonaccrual impaired troubled debt restructured loans. As of December 31, 2017, there was \$66,000 of charge-offs associated with troubled debt restructured loans while under a forbearance agreement. As of December 31, 2017, there were no defaulted troubled debt restructured loans, as all troubled debt

restructured loans were current with respect to their associated forbearance agreements. There were also no defaults on troubled debt restructured loans within twelve months of restructure during 2017.

There were no troubled debt restructured loans added during the three or six months ended June 30, 2018 and 2017. As a result of management evaluations at June 30, 2018, June 30, 2017, and December 31, 2017, any specific allocations and charge-offs have been taken as appropriate. There were no charge-offs associated with existing troubled debt restructured loan relationships for the three or six months ended June 30, 2018 or 2017. There were no troubled debt restructured loans that defaulted within twelve months of restructure during the three and six months ended June 30, 2018 and 2017.

As of June 30, 2018, Mid Penn had \$912,000 of residential real estate held in other real estate owned. There were four consumer mortgage loans secured by residential real estate properties totaling \$274,000 for which formal foreclosure proceedings were in process. As of December 31, 2017, Mid Penn had \$42,000 of residential real estate held in other real estate owned, and \$308,000 in loans for which formal foreclosure proceedings were in process.

## MID PENN BANCORP, INC.

The following tables provide activity for the accretable yield of acquired impaired loans from both the Phoenix Bancorp, Inc. (2015) and Scottsdale (2018) acquisitions for the three and six months ended June 30, 2018.

(Dollars in thousands)

Accretable yield, April 1, 2018	\$ 336
Accretable yield amortized to interest income	(36 )
Reclassification from nonaccretable difference (a)	-
Accretable yield, June 30, 2018	\$ 300

(Dollars in thousands)

Accretable yield, January 1, 2018	\$ 67
Acquisition of impaired loans	\$ 305
Accretable yield amortized to interest income	(72 )
Reclassification from nonaccretable difference (a)	-
Accretable yield, June 30, 2018	\$ 300

(a) Reclassification from non-accretable difference represents an increase to the estimated cash flows to be collected on the underlying portfolio.

#### (5) Fair Value Measurement

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance provides additional information on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes information on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with the fair value measurement and disclosure guidance.

This guidance clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Inputs to valuation techniques refer to the assumptions that market participants would use in measuring the fair value of an asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or

unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. An asset's or liability's placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement or disclosure. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Inputs - Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 Inputs - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

There were no transfers of assets between fair value Level 1 and Level 2 during the six months ended June 30, 2018 or 2017.

## MID PENN BANCORP, INC.

The following tables illustrate the assets measured at fair value on a recurring basis segregated by hierarchy fair value levels.

(Dollars in thousands)	Total carrying value at	Fair value measurements at June 30, 2018 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:	June 30, 2018			
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 38,340	\$-	\$ 38,340	\$ -
Mortgage-backed U.S. government agencies	42,426	-	42,426	-
State and political subdivision obligations	29,574	-	29,574	-
Corporate debt securities	1,351	-	1,351	-
Other assets:				
Equity securities	492	492	-	-
Loans held for sale	1,185	1,185	-	-
Total	\$ 113,368	\$1,677	\$ 111,691	\$ -

(Dollars in thousands)	Total carrying value at	Fair value measurements at December 31, 2017 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:	December 31, 2017			
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 38,730	\$-	\$ 38,730	\$ -
Mortgage-backed U.S. government agencies	25,831	-	25,831	-
State and political subdivision obligations	27,043	-	27,043	-
Corporate debt securities	1,355	-	1,355	-
Other assets:				
Equity securities	506	506	-	-
Loans held for sale	1,040	1,040	-	-
Total	\$ 94,505	\$1,546	\$ 92,959	\$ -

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

The following tables illustrate the assets measured at fair value on a nonrecurring basis segregated by hierarchy fair value levels.

(Dollars in thousands)	Total carrying value at	Fair value measurements at June 30, 2018 using:		
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:	June 30, 2018			
Impaired Loans	\$ 4,689	\$-	\$ -	\$ 4,689
Foreclosed Assets Held for Sale	29	-	-	29
Mortgage Servicing Rights	111	-	-	111

(Dollars in thousands)	Total carrying value at	Fair value measurements at December 31, 2017 using:		
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:	December 31, 2017			
Impaired Loans	\$ 6,090	\$-	\$ -	\$ 6,090
Foreclosed Assets Held for Sale	-	-	-	-
Mortgage Servicing Rights	126	-	-	126



## MID PENN BANCORP, INC.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Mid Penn has utilized Level 3 inputs to determine the fair value.

(Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements					
	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average
June 30, 2018	Estimate				
Impaired Loans	\$4,689	Appraisal of collateral (a)	Appraisal adjustments (b)	16% - 63%	27%
Foreclosed Assets Held for Sale	29	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	29% - 29%	29%
Mortgage Servicing Rights	111	Multiple of annual service fee	Estimated prepayment speed based on rate and term	70% - 100%	99%

(Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements					
	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average
December 31, 2017	Estimate				
Impaired Loans	\$6,090	Appraisal of collateral (a)	Appraisal adjustments (b)	6% - 51%	28%
Foreclosed Assets Held for Sale	-	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	0% - 0%	0%
Mortgage Servicing Rights	126	Multiple of annual service fee	Estimated prepayment speed based on rate and term	70% - 100%	98%

- (a) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not observable.
- (b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received, or age of the appraisal.
- (c) Includes qualitative adjustments by management and estimated liquidation expenses.

Mid Penn uses the following methodologies and assumptions to estimate the fair value of certain assets and liabilities.

#### Cash and Cash Equivalents:

The carrying value of cash and cash equivalents is considered to be a reasonable estimate of fair value.

#### Interest-bearing Balances with other Financial Institutions:

The estimate of fair value was determined by comparing the present value of quoted interest rates on like deposits with the weighted average yield and weighted average maturity of the balances.

Securities Available for Sale:

The fair value of securities classified as available-for-sale is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather, relying on the securities' relationship to other benchmark quoted prices.

Held-to-Maturity Securities:

The fair values of held-to-maturity securities are based on a market approach using observable inputs such as benchmark yields and securities, reported trades, issuer spreads, current bids and offers, monthly payment information and collateral performance.

MID PENN BANCORP, INC.

Loans Held for Sale:

The fair values of mortgage loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors.

Impaired Loans (included in “Net Loans and Leases” in the following tables):

Mid Penn’s rating system assumes any loans classified as substandard and nonaccrual to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn’s impaired loans, whether reporting a specific allowance allocation or not, are considered collateral dependent.

It is Mid Penn’s policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as substandard nonaccrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance for loan loss issues; however, no allowance recommendation will be made until Mid Penn is in receipt of the updated valuation.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management’s judgment, if deemed necessary. Mid Penn considers the estimates used in its impairment analysis to be Level 3 inputs.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values, either in a positive or negative way, due to the passage of time or some other change in one or more valuation inputs. Collateral values for impaired loans will be reassessed by management at least every 12 months for possible revaluation by an independent third party.

Loans:

Loan fair values as of June 30, 2018 are estimated using an exit price approach, which incorporates discounts for credit risk and prepayment risk and considers the value indicated by current market expectations in the estimated fair value of the loan portfolio.

Loan fair values as of December 31, 2017 were calculated using the entrance price approach. Under this approach, variable rate loans that reprice frequently and which entail no significant changes in credit risk had a fair value approximating carrying value. The fair value of other loans was estimated by calculating the present value of the cash flow difference between the current rate and the market rate, for the average maturity, discounted quarterly at the market rate.

Foreclosed Assets Held for Sale:

Certain assets included in foreclosed assets held for sale are carried at fair value and accordingly is presented as measured on a non-recurring basis. Values are estimated using Level 3 inputs, based on appraisals that consider the sales prices of property in the proximate vicinity.

Accrued Interest Receivable and Payable:

The carrying amount of accrued interest receivable and payable approximates their fair values.

Restricted Investment in Bank Stocks:

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Mortgage Servicing Rights:

The fair value of servicing rights is based on the present value of estimated future cash flows on pools of mortgages stratified by rate and maturity date.

Deposits:

The fair value for demand deposits (e.g., interest and noninterest checking, savings, and money market deposit accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair value for fixed-rate certificates of deposit was estimated using a discounted cash flow calculation by combining all fixed-rate certificates into a pool with a weighted average yield and a weighted average maturity for the pool and comparing the pool with interest rates currently being offered on a similar maturity.

Short-term Borrowings:

Because of time to maturity, the estimated fair value of short-term borrowings approximates the book value.

Long-term and Subordinated Debt:

The estimated fair values of long-term and subordinated debt were determined using discounted cash flow analysis, based on currently available borrowing rates for similar types of borrowing arrangements.

## MID PENN BANCORP, INC.

## Commitments to Extend Credit and Letters of Credit:

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present creditworthiness of the counterparties. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements.

The following table summarizes the carrying value and fair value of financial instruments at June 30, 2018 and December 31, 2017.

(Dollars in thousands)	June 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$39,407	\$39,407	\$23,514	\$23,514
Available-for-sale investment securities	111,691	111,691	93,465	93,465
Held-to-maturity investment securities	153,321	150,016	101,356	100,483
Loans held for sale	1,185	1,185	1,040	1,040
Net loans and leases	1,028,290	1,034,131	902,798	917,081
Restricted investment in bank stocks	2,765	2,765	4,384	4,384
Accrued interest receivable	5,372	5,372	4,564	4,564
Mortgage servicing rights	111	111	126	126
<b>Financial liabilities:</b>				
Deposits	\$1,236,518	\$1,236,604	\$1,023,568	\$1,026,830
Short-term borrowings	-	-	34,611	34,611
Long-term debt	12,241	11,978	12,352	11,692
Subordinated debt	17,342	17,245	17,338	17,358
Accrued interest payable	1,186	1,186	645	645
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	\$-	\$-	\$-	\$-
Financial standby letters of credit	-	-	-	-

The following tables present the carrying amount, fair value, and placement in the fair value hierarchy of Mid Penn's financial instruments as of June 30, 2018 and December 31, 2017. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions, loans held for sale, restricted investment in bank stocks, mortgage servicing rights, accrued interest receivable and payable, and short-term borrowings. Other than cash and cash equivalents, which are considered Level 1 Inputs and mortgage servicing rights, which are Level 3 Inputs, these instruments are Level 2 Inputs. These tables exclude financial instruments for which the carrying amount approximates fair value, not previously disclosed.

(Dollars in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)			Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
<b>Financial instruments - assets</b>									
Held-to-maturity investment									
securities	\$153,321	\$150,016	\$-	\$150,016	\$-				
Net loans and leases	1,028,290	1,034,131	-	-				1,034,131	
<b>Financial instruments - liabilities</b>									
Deposits	\$1,236,518	\$1,236,604	\$-	\$1,236,604	\$-				
Long-term debt	12,241	11,978	-	11,978	-				
Subordinated debt	17,342	17,245	-	17,245	-				

MID PENN BANCORP, INC.

(Dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017					
Financial instruments - assets					
Held-to-maturity investment					
securities	\$ 101,356	\$ 100,483	\$-	\$ 100,483	\$ -
Net loans and leases	902,798	917,081	-	-	917,081
Financial instruments -					
liabilities					
Deposits	\$ 1,023,568	\$ 1,026,830	\$-	\$ 1,026,830	\$ -
Long-term debt	12,352	11,692	-	11,692	-
Subordinated debt	17,338	17,358		17,358	

**(6) Guarantees and Commitments**

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Mid Penn evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Mid Penn had \$20,647,000 and \$20,496,000 standby letters of credit outstanding as of June 30, 2018 and December 31, 2017, respectively. Mid Penn does not anticipate any losses because of these transactions. The amount of the liability as of June 30, 2018 and December 31, 2017 for payment under standby letters of credit issued was not material.

As of June 30, 2018, Mid Penn had entered into a commitment to purchase a limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units will qualify for Federal Low-Income Housing Tax Credits (“LIHTCs”) as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn’s limited partner capital contribution commitment is \$7,593,000 which will be paid in installments over the course of construction of the low-income housing facilities. The investment in the limited partnership will be reported in other assets on the balance sheet and amortized over a ten year period. The project has been conditionally awarded \$863,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of \$8,629,000 to be delivered to Mid Penn over the ten year amortization period. Mid Penn’s commitment to purchase the limited partnership interest is conditional upon (i) the review and approval of all closing document, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it may deem necessary.

(7) Subordinated Debt

Subordinated Debt Issued December 2017

On December 19, 2017, Mid Penn entered into agreements with investors to purchase \$10,000,000 aggregate principal amount of its Subordinated Notes due 2028 (the “2017 Notes”). The 2017 Notes are intended to be treated as Tier 2 capital for regulatory capital purposes. The offering closed in December 2017.

The 2017 Notes bear interest at a rate of 5.25% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no times be less than 5.0%. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, beginning on July 15, 2018, for the first five years after issuance and will be payable quarterly in arrears thereafter on January 15, April 15, July 15, and October 15. The 2017 Notes will mature on January 1, 2028 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 21, 2022, and prior to January 1, 2028. Additionally, Mid Penn may redeem the 2017 Notes in whole at any time, or in part from time to time, upon at least 30 days’ notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2017 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2017 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended. In the event of a redemption described in the previous sentence, Mid Penn will redeem the 2017 Notes at 100% of the principal amount of the 2017 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.



MID PENN BANCORP, INC.

Holders of the 2017 Notes may not accelerate the maturity of the 2017 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar event of Mid Penn or Mid Penn Bank, its principal banking subsidiary.

#### Subordinated Debt Issued December 2015

On December 9, 2015, Mid Penn sold \$7,500,000 aggregate principal amount of Subordinated Debt (the "2015 Notes") due 2025. The 2015 Notes are treated as Tier 2 capital for regulatory capital purposes.

The 2015 Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal's Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The 2015 Notes will mature on December 9, 2025 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 9, 2020, and prior to December 9, 2025. Additionally, Mid Penn may redeem the 2015 Notes in whole at any time, or in part from time to time, upon at least 30 days' notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2015 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2015 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended, in each case at 100% of the principal amount of the 2015 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the 2015 Notes may not accelerate the maturity of the 2015 Notes, except upon Mid Penn's or Mid Penn Bank's bankruptcy, insolvency, liquidation, receivership or similar event.

ASC Subtopic 835-30, Simplifying the Presentation of Debt Issuance Costs, requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability. The unamortized debt issuance costs associated with the 2015 Notes and the 2017 Notes were collectively \$158,000 at June 30, 2018 and \$162,000 at December 31, 2017.

#### (8) Defined Benefit Plans

Mid Penn has an unfunded noncontributory defined benefit retirement plan for directors. The plan provides defined benefits based on years of service. Mid Penn also sponsors a defined benefit health care plan that provides post-retirement medical benefits and life insurance to qualifying full-time employees. These health care and life insurance plans are noncontributory and each plan uses a December 31 measurement date.

As a result of the acquisition of Scottsdale on January 8, 2018, Mid Penn has assumed a noncontributory defined benefit pension plan covering certain former employees of Scottsdale. Mid Penn estimates it will contribute \$600,000 to the defined benefit pension plan in 2018. A December 31 measurement date for the plan is used.

The components of net periodic benefit costs from these defined benefit plans are as follows:

(Dollars in thousands)	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2018	2017	2018	2017
Service cost	\$153	\$9	\$1	\$1
Interest cost	205	11	5	5
Expected return on plan assets	(211)	-	-	-
Amortization (accretion) of prior service cost	4	4	(5)	(6)
Settlement gain	(380)	-	-	-
Net periodic benefit (income) expense	\$(229)	\$24	\$1	\$-

(Dollars in thousands)	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2018	2017	2018	2017
Service cost	\$161	\$18	\$2	\$2
Interest cost	215	22	9	10
Expected return on plan assets	(211)	-	-	-
Amortization (accretion) of prior service cost	8	7	(10)	(12)
Settlement gain	(380)	-	-	-
Net periodic benefit (income) expense	\$(207)	\$47	\$1	\$-

MID PENN BANCORP, INC.

## (9) Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of taxes, are as follows:

	Unrealized Loss on Securities	Defined Benefit Plans	Accumulated Other Comprehensive Loss
(Dollars in thousands)			
Balance - June 30, 2018	\$ (4,361 )	\$ 1,127	\$ (3,234 )
Balance - December 31, 2017	\$ (2,159 )	\$ 85	\$ (2,074 )

## (10) Restricted Common Stock

On May 6, 2014, Mid Penn shareholders approved the 2014 Restricted Stock Plan (the “Plan”), which authorizes the issuance of awards that shall not exceed, in the aggregate, 100,000 shares of common stock. Awards under the Plan are limited to employees and directors of the Company and the Bank selected by the Compensation Committee of the Board of Directors, to advance the best interest of Mid Penn and its shareholders.

Share-based compensation expense relating to restricted stock is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and benefits expense. As of June 30, 2018, a total of 25,995 restricted shares were granted under the Plan, with 6,986 of the granted shares being vested, while the remaining 19,009 granted shares remain unvested. 490 shares were forfeited due to voluntary termination of an employee during the three and six months ended June 30, 2018, while no shares were forfeited during the same periods in 2017. The Plan shares granted and vested resulted in \$55,000 in compensation expense for the three months ended June 30, 2018, while \$19,000 of share-based compensation expense was recorded for the three months ended June 30, 2017. Compensation expense related to the Plan was \$113,000 for the six months ended June 30, 2018, while it was \$37,000 for the same period in 2017.

## (11) Revenue Recognition

Mid Penn recognizes revenues when earned based upon (i) contractual terms as transactions occur, or (ii) as related services are provided and collectability is reasonably assured. The largest source of revenue for Mid Penn is interest income, which is primarily recognized on an accrual basis according to a written contract, such as loan and lease agreements or investment securities contracts. Mid Penn earns noninterest income through a variety of financial and transactional services such as trust and wealth management services, deposit account transaction fees, ATM debit card fees, and mortgage banking fees. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed. In certain circumstances, noninterest income is reported net of associated expenses.

On January 1, 2018, Mid Penn adopted FASB ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU establishes principles for reporting information about the nature, timing, and uncertainty of revenue and

cash flows arising from the entity's contracts to provide goods and services to customers. ASU 2014-09 applies primarily to transactional-based non-interest income revenue streams and excludes mortgage banking income, earnings from cash surrender value of life insurance, and gains on SBA loans.

Mid Penn's non-interest income revenue streams of income from fiduciary activities, service charges on deposits, ATM debit charge interchange income, merchant service fees and components of other income are within the scope of Topic 606. Within these various non-interest income streams, Mid Penn enters into business contracts with customers to perform a variety of services. These services include but not limited to (i) agreed-upon tasks (e.g. initiating a wire transfer or trust and investment management services), (ii) service of standing ready to provide goods and services (e.g. letter of credit arrangements), and (iii) arranging for another party to transfer goods or services to a customer (e.g. check order fees). Typically, contracts are approved in writing, but can also be approved in accordance with other customary business practices. The majority of the performance obligations at Mid Penn are distinct and are satisfied at a point in time and typically the transaction prices are fixed and are documented in either a fee schedule, such as non-sufficient funds fees or wire fees, or calculated as a percentage of assets under management for trust and wealth management income streams. The transaction price is not recognized in revenue until the service has occurred, or monthly in arrears for assets under management. Mid Penn does not exercise significant judgements in the recognition of income, as typically income is not recognized until the performance obligation has been satisfied. Mid Penn has not recognized any assets from the costs to obtain or fulfill a contract with customers for revenue streams that fall within the guidance of Topic 606.

MID PENN BANCORP, INC.

## (12) Earnings per Common Share

Earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during each of the years presented. The following data show the amounts used in computing basic earnings per common share.

The computations of basic earnings per common share follow:

(Dollars in thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Net income	\$2,779	\$2,345	\$3,783	\$4,339
Weighted average common shares outstanding	6,122,757	4,234,291	6,049,261	4,234,525
Basic and diluted earnings per common share	\$0.45	\$0.55	\$0.63	\$1.02

The increase in the weighted average shares outstanding at June 30, 2018 was impacted by the issuance of 1,878,827 shares of Mid Penn common stock on January 8, 2018 in connection with the Scottsdale acquisition. Mid Penn had no dilutive instruments outstanding during the periods ended June 30, 2018 and 2017.

## (13)

## Recent Accounting Pronouncements

ASU 2016-13: The FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.

The ASU requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (“CECL”) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”) should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. Certain incremental disclosures are required.

The Update has tiered effective dates, with early adoption permitted for all entities as of the fiscal year beginning after December 15, 2018. For public business entities that are SEC filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

Mid Penn is currently evaluating the details of this ASU and the impact the guidance will have on Mid Penn's consolidated financial statements. Mid Penn expects that it is possible that the ASU may result in an increase in the allowance for credit losses resulting from the change to expected losses for the estimated life of the financial asset, including an allowance for debt securities. The amount of the change in the allowance for credit losses, if any, resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption.

ASU 2016-02: The FASB issued ASU 2016-02, Leases.

The new leases standard applies a right-of-use ("ROU") model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating based on five criteria. Balance sheet recognition of finance and operating leases is similar, but the pattern of expense recognition in the income statement, as well as the effect on the statement of cash flows, differs depending on the lease classification.

MID PENN BANCORP, INC.

The new leases standard requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP. Classification depends on the same five criteria used by lessees plus certain additional factors. The subsequent accounting treatment for all three lease types is substantially equivalent to existing U.S. GAAP for sales-type leases, direct financing leases, and operating leases. However, the new standard updates certain aspects of the lessor accounting model to align it with the new lessee accounting model, as well as with the new revenue standard under Topic 606.

Lessees and lessors are required to provide certain qualitative and quantitative disclosures to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The new leases standard addresses other considerations including identification of a lease, separating lease and non-lease components of a contract, sale and leaseback transactions, modifications, combining contracts, reassessment of the lease term, and re-measurement of lease payments. It also contains comprehensive implementation guidance with practical examples.

On July 30, 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides an option to apply the transition provisions of the new standard at the adoption date instead of the earliest comparative period presented. Additionally, the ASU provides a practical expedient permitting lessors to not separate non-lease components from the associated lease component if certain conditions are met.

The amendments for both ASUs are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Specific transition requirements apply.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Specific transition requirements apply.

Mid Penn occupies certain offices under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. Mid Penn expects to recognize lease liabilities and ROU assets associated with these lease agreements as required by the ASU; however, the extent of the prospective impact on Mid Penn's consolidated financial statements and the materiality will be dependent upon the extent and type of lease arrangements involving Mid Penn at the time of the adoption of this standard.

ASU 2018-07: The FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

The ASU makes certain changes to the accounting for nonemployee awards to align the accounting for share-based payment awards issued to employees and nonemployees. The changes require that the compensation expense associated with nonemployee equity awards with performance conditions be recognized when the achievement of the performance condition is probable, rather than upon achievement of the performance condition. Additionally, the new ASU requires that equity-classified share-based payment awards issued to nonemployees be measured on the grant date, versus the previous GAAP requirement to re-measure the awards through the performance completion date. The current requirement to reassess the classification (equity or liability) for the nonemployee awards upon vesting will be eliminated.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted, including interim periods.

Mid Penn currently issues restricted stock awards to nonemployee directors through the 2014 Restricted Stock Plan (the "Plan"). The single performance condition of the award is that the individual remain a director of Mid Penn

through the duration of the vesting period. Mid Penn is currently evaluating the details of this ASU and expects that the adoption of this ASU will not have a material impact on our consolidated financial statements as the compensation expense related to nonemployee equity awards is immaterial to Mid Penn's overall financial condition.

(14) Subsequent Events

Merger – First Priority Financial Corp.

After the close of business on July 31, 2018, Mid Penn completed its acquisition of First Priority Financial Corp. (“First Priority”), through the merger of First Priority with and into Mid Penn pursuant to the previously announced Agreement and Plan of Merger (the “Merger Agreement”), dated as of January 16, 2018, between Mid Penn and First Priority. In connection with this acquisition, First Priority Bank, First Priority's wholly owned bank subsidiary, was merged with and into Mid Penn Bank. Pursuant to the Merger Agreement, shareholders of First Priority received 0.3481 shares of Mid Penn common stock for each share of First Priority common stock they owned. Additionally, in accordance with the Merger Agreement, outstanding options to purchase First Priority common stock at the time of the merger were converted to the right to receive cash at a per-option value of \$11.07 less the exercise price, without interest. As a result of the acquisition, Mid Penn's fulfillment of the merger consideration requirements resulted in the issuance of approximately 2.3 million shares of Mid Penn common stock, and the payment of cash related to options of approximately \$3.9 million. Mid Penn also issued 3,404 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series D, having a fixed dividend rate of 9 percent per annum, in exchange for the 3,404 shares of First Priority preferred shares outstanding as of the closing of the merger. The acquisition expands Mid Penn's footprint into southeastern Pennsylvania, including Chester, Berks, Montgomery, and Bucks counties. Based upon the total merger consideration from Mid Penn, the transaction was valued at approximately \$79,904,000. At June 30, 2018, and thirty days prior to the acquisition transaction, First Priority Bank reported total assets of \$627,428,000, total loans of \$522,036,000, and total deposits of \$513,582,000 on a Call Report filed with federal banking regulators.



MID PENN BANCORP, INC.

Given that the initial purchase accounting for the acquisition in accordance with generally accepted accounting principles for this business combination is not yet completed, Mid Penn is not yet able to disclose the preliminary fair value of the First Priority assets acquired and liabilities assumed.

#### Litigation

In connection with the merger acquisition of First Priority (the “Merger”), on May 31, 2018, Mid Penn and First Priority filed with the Securities and Exchange Commission (the “SEC”) a Joint Proxy Statement/Prospectus on Form S-4 (SEC File No. 333- 225304) that was declared effective by the SEC on June 19, 2018 (the “Joint Proxy Statement/Prospectus”). The Joint Proxy Statement/Prospectus was first mailed to the shareholders of First Priority on or about June 20, 2018.

On July 13, 2018, counsel for Mid Penn and First Priority received notification that a complaint was filed in the Court of Common Pleas of Chester County, Pennsylvania, against members of the board of directors of First Priority, First Priority and Mid Penn. The lawsuit, which is captioned Parshall v. Sparks, et al., Case No. 2018-07025-MJ, alleges claims brought directly by one First Priority shareholder, Paul Parshall, but purports to state class claims on behalf of all First Priority shareholders. The lawsuit is based on allegations that the First Priority directors breached their fiduciary duty through material misstatements and/or omissions in the proxy statement/prospectus distributed to shareholders of First Priority and Mid Penn in connection with the pending merger of First Priority with and into Mid Penn. The lawsuit further alleges that the merger consideration is inadequate. Mid Penn is alleged to have aided and abetted the First Priority directors’ alleged breaches of their fiduciary duties. The lawsuit seeks, among other remedies, to enjoin the merger or, in the event the merger is completed, rescission of the merger or rescissory damages; unspecified damages; and costs of the lawsuit, including attorneys’ and experts’ fees. Mid Penn believes that the lawsuit is without merit as there are substantial legal and factual defenses to the claims asserted and intends to vigorously defend the lawsuit. It is not possible at this time to estimate reasonably possible losses, or even a range of reasonably possible losses, in connection with the litigation.

MID PENN BANCORP, INC.

## ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is Management’s Discussion of Consolidated Financial Condition as of June 30, 2018, compared to year-end 2017, and the Results of Operations for the three and six months ended June 30, 2018, compared to the same period in 2017. For comparative purposes, the June 30, 2018 and December 31, 2017 balances have been reclassified, when, and if necessary, to conform to the 2018 presentation. Such reclassifications had no impact on net income. This discussion should be read in conjunction with the financial tables, statistics, and the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Annual Report”). The results of operations for interim periods are not necessarily indicative of operating results expected for the full year.

### Caution About Forward-Looking Statements

Forward-looking statements involve risks, uncertainties and assumptions. Although Mid Penn generally does not make forward-looking statements unless Mid Penn’s management believes its management has a reasonable basis for doing so, Mid Penn cannot guarantee the accuracy of any forward-looking statements. Actual results may differ materially from those expressed in any forward-looking statements due to a number of uncertainties and risks, including the risks described in this Quarterly Report on Form 10-Q, the 2017 Annual Report, and other unforeseen risks. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Quarterly Report on Form 10-Q, even if subsequently made available by us on Mid Penn’s website or otherwise, and Mid Penn undertakes no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Mid Penn to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect”, “anticipates”, “intend”, “plan”, “believe”, “estimate”, and similar expressions are intended to identify such forward-looking statements. Mid Penn’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- the effects of potentially slowing or volatile future economic conditions on Mid Penn and its customers;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- future actions or inactions of the United States government, including a failure to increase the government debt limit or a prolonged shutdown of the federal government;

- an increase in the Pennsylvania Bank Shares Tax to which Mid Penn Bank's capital stock is currently subject, or imposition of any additional taxes on Mid Penn or Mid Penn Bank;
- impacts of the capital and liquidity requirements imposed by the Basel III standards and other regulatory pronouncements and rules;
- the effect of changes in accounting policies and practices, as may be adopted by the supervisory agencies, as well as the Public Company Accounting Oversight Board, Financial Accounting Standards Board, and other accounting standard setters;
- the risks of changes in interest rates on the level and composition of deposits and other funding sources, loan demand and yields, values of loan collateral, securities and yields, and interest rate protection agreements;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- technological changes;
- our ability to implement business strategies, including our acquisitions of First Priority Financial Corp. ("First Priority") and The Scottdale Bank and Trust Company ("Scottdale"), and other business acquisition activities and organic branch, product and service expansion strategies;
- our current and future acquisition strategies may not be successful in locating or acquiring advantageous targets at favorable prices;
- our ability to successfully integrate any banks, companies, assets, liabilities, customers, systems and management personnel we acquire into our operations, including those related to our acquisitions of First Priority and Scottdale, and our ability to realize related revenue synergies and cost savings within expected time frames;
- potential goodwill impairment charges, future impairment charges and fluctuations in the fair values of reporting units or of assets in the event projected financial results are not achieved within expected time frames;
- our ability to attract and retain qualified management and personnel;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- results of regulatory examination and supervision processes;
- our ability to maintain compliance with the exchange rules of The NASDAQ Stock Market LLC;
- the failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;
- acts of war or terrorism; disruptions due to flooding, severe weather, or other natural disasters or Acts of God; and
- volatility in the securities markets.

The above list of factors that may affect future performance is illustrative, but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with this understanding of inherent uncertainty.

MID PENN BANCORP, INC.

### Critical Accounting Estimates

Mid Penn's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and conform to general practices within the banking industry. Application of these principles involves significant judgments and estimates by management that have a material impact on the carrying value of certain assets and liabilities. The judgments and estimates that we used are also based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations. Management of the Company considers the accounting judgments relating to the allowance, the evaluation of the Company's investment securities for other-than-temporary impairment, the valuation of the Company's goodwill and other merger-related intangible assets for impairment, and the valuation of assets acquired and liabilities assumed in business combinations, to be the accounting areas that require the most subjective and complex judgments.

The allowance represents management's estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the consolidated balance sheet. Throughout the remainder of this report, the terms "loan" or "loans" refers to both loans and leases.

Valuations for the investment portfolio are determined using quoted market prices, where available. If quoted market prices are not available, investment valuation is based on pricing models, quotes for similar investment securities, and observable yield curves and spreads. In addition to securities valuation, management must assess whether there are any declines in value below the carrying value of the investments that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of the loss in the consolidated statement of income.

Certain intangible assets generated in connection with acquisitions are periodically assessed for impairment. Goodwill is tested annually for impairment, and if certain events occur which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this assessment, Mid Penn considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. Similarly, the amortized basis of the core deposit intangible asset is periodically assessed for impairment. There are inherent uncertainties related to these factors and Mid Penn's judgment in applying them to the analysis of core deposit intangible and goodwill impairment. Changes in economic and operating conditions could result in goodwill and core deposit intangible impairment in future periods.

Valuations of assets acquired and liabilities assumed in business combinations are measured at fair value as of the acquisition date. In many cases, determining the fair value of the assets acquired and liabilities assumed requires Mid Penn to estimate cash flows expected to result from these assets and liabilities and to discount these cash flows at appropriate rates of interest, which require the utilization of significant estimates and judgment in accounting for the acquisition.

## Results of Operations

### Overview

Net income was \$2,779,000 or \$0.45 per common share, for the quarter ended June 30, 2018, compared to net income of \$2,345,000 or \$0.55 per common share, for the quarter ended June 30, 2017. During the six months ended June 30, 2018, net income was \$3,783,000,000 or \$0.63 per common share, versus \$4,339,000 or \$1.02 per common share, for the six months ended June 30, 2017.

Net income as a percent of (i) average assets (return on average assets, or “ROA”) and (ii) shareholders' equity (return on average equity, or “ROE”) were as follows (calculated and reported on an annualized basis):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
Return on average assets	0.79%	0.86%	0.55%	0.82%
Return on average equity	7.90%	12.74%	5.34%	12.05%

### Net Interest Income/Funding Sources

Net interest income, Mid Penn’s primary source of revenue, is the amount by which interest income on loans and investments exceeds interest incurred on deposits and borrowings. The amount of net interest income is affected by changes in interest rates and changes in the volume and mix of interest-sensitive assets and liabilities. Net interest income and corresponding yields are presented in the analysis below on a taxable-equivalent basis. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is adjusted by an amount equivalent to the federal income taxes which would have been paid if the income received on these assets was taxable at the statutory rate of 21 percent for the three and six months ended June 30, 2018 and 34 percent for the three and six months ended June 30, 2017. The decrease in the statutory rate to 21 percent, which became effective January 1, 2018, was a result of the Tax Cuts and Jobs Act enacted December 22, 2017.



## MID PENN BANCORP, INC.

The following tables include average balances, amounts, and rates of interest income and expense, interest rate spread, and net interest margin for the three and six months ended June 30, 2018 and 2017.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis						
	For the Three Months Ended						
	June 30, 2018			June 30, 2017			
	Average Balance	Interest	Average Rates		Average Balance	Interest	Average Rates
<b>ASSETS:</b>							
Interest Bearing Balances	\$ 4,755	\$ 17	1.43 %		\$ 2,663	\$ 5	0.75 %
Investment Securities:							
Taxable	163,247	913	2.24 %		122,661	604	1.98 %
Tax-Exempt	95,868	695 (a)	2.91 %		50,052	401 (a)	3.21 %
Total Securities	259,116	1,608	2.49 %		172,713	1,005	2.33 %
Federal Funds Sold	34,137	153	1.80 %		8,766	23	1.05 %
Loans and Leases, Net	1,017,666	12,137 (b)	4.78 %		848,980	10,060 (b)	4.75 %
Restricted Investment in Bank Stocks	2,825	47	6.67 %		2,702	33	4.90 %
Total Earning Assets	1,318,499	13,962	4.25 %		1,035,824	11,126	4.31 %
Cash and Due from Banks	23,112				21,728		
Other Assets	70,354				33,831		
Total Assets	\$ 1,411,965				\$ 1,091,383		
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b>							
Interest-bearing Demand	\$ 358,192	527	0.59 %		\$ 335,556	294	0.35 %
Money Market	275,320	587	0.86 %		249,928	357	0.57 %
Savings	172,815	75	0.17 %		63,372	10	0.06 %
Time	223,744	808	1.45 %		193,688	616	1.28 %
Total Interest-bearing Deposits	1,030,071	1,997	0.78 %		842,544	1,277	0.61 %
Short-term Borrowings	—	—	0.00 %		4,472	13	1.17 %
Long-term Debt	12,269	74	2.42 %		13,496	80	2.38 %
Subordinated Debt	17,339	235	5.44 %		7,417	99	5.35 %
Total Interest-bearing Liabilities	1,059,679	2,306	0.87 %		867,929	1,469	0.68 %
Noninterest-bearing Demand	199,299				138,423		
Other Liabilities	13,353				11,188		
Shareholders' Equity	139,634				73,843		
Total Liabilities & Shareholders' Equity	\$ 1,411,965				\$ 1,091,383		
		\$ 11,656				\$ 9,657	

Net Interest Income (taxable equivalent basis)				
Taxable Equivalent Adjustment	(242 )		(247 )	
Net Interest Income	\$ 11,414		\$ 9,410	
Total Yield on Earning Assets	4.25 %		4.31 %	
Rate on Supporting Liabilities	0.87 %		0.68 %	
Average Interest Spread	3.37 %		3.63 %	
Net Interest Margin	3.55 %		3.74 %	

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of \$178,000 and \$136,000 for the three months ended June 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at June 30, 2018 and 2017, respectively.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of \$64,000 and \$111,000 for the three months ended June 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at June 30, 2018 and 2017, respectively.



## MID PENN BANCORP, INC.

(Dollars in thousands on a Taxable Equivalent Basis)	Three months ended June 30, 2018 vs. 2017		
	Increase (decrease)		
	Volume	Rate	Net
<b>INTEREST INCOME:</b>			
Interest Bearing Balances	\$4	\$8	\$12
<b>Investment Securities:</b>			
Taxable	200	109	309
Tax-Exempt	367	(73 )	294
Total Securities	567	36	603
Federal Funds Sold	67	63	130
Loans and Leases, Net	1,999	78	2,077
Restricted Investment Bank Stocks	2	12	14
Total Interest Income	2,639	197	2,836
<b>INTEREST EXPENSE:</b>			
<b>Interest Bearing Deposits:</b>			
Interest Bearing Demand	80	153	233
Money Market	145	85	230
Savings	69	(4 )	65
Time	383	(191)	192
Total Interest Bearing Deposits	677	43	720
Short-term Borrowings	(52 )	39	(13 )
Long-term Debt	(29 )	23	(6 )
Subordinated Debt	531	(395)	136
Total Interest Expense	1,127	(290)	837
<b>NET INTEREST INCOME</b>	<b>\$1,512</b>	<b>\$487</b>	<b>\$1,999</b>

Taxable-equivalent net interest income was \$11,656,000 for the three months ended June 30, 2018, an increase of \$1,999,000 or 21 percent compared to the three months ended June 30, 2017. Net interest income in the second quarter of 2018 was positively impacted by \$71,809,000 of loans and \$114,039,000 of investment securities acquired in the purchase of Scottdale on January 8, 2018.

For the three months ended June 30, 2018, Mid Penn's tax-equivalent net interest margin was 3.55% compared to 3.74% for the three months ended June 30, 2017. The decrease in the net interest margin year over year was attributed to both an increase in the cost of funds and a lower yield earned on the loan portfolio. The cost of funds increased to 0.87% for the second quarter of 2018, versus 0.68% for the second quarter of 2017, primarily as a result of the impact of the Federal Open Market Committee ("FOMC") rate increases in the past twelve months. For the three months ended June 30, 2018, the overall loan portfolio yield was 4.78%, compared to a loan portfolio yield of 4.75% for the same period in 2017. The loan yield for the second quarter of 2018 reflects the impact of Scottdale loans acquired at fair value on January 8, 2018.



## MID PENN BANCORP, INC.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis						
	For the Six Months Ended						
	June 30, 2018			June 30, 2017			
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates	
<b>ASSETS:</b>							
Interest Bearing Balances	\$ 4,273	\$ 26	1.23 %	\$ 2,462	\$ 7	0.57 %	
<b>Investment Securities:</b>							
Taxable	158,381	1,751	2.23 %	109,670	1,070	1.97 %	
Tax-Exempt	95,644	1,341 (a)	2.83 %	52,511	879 (a)	3.38 %	
Total Securities	254,025	3,092	2.45 %	162,181	1,949	2.42 %	
Federal Funds Sold	39,284	321	1.65 %	15,976	74	0.93 %	
Loans and Leases, Net	997,749	23,534 (b)	4.76 %	836,702	19,885 (b)	4.79 %	
Restricted Investment in Bank Stocks	2,875	133	9.33 %	2,518	56	4.48 %	
Total Earning Assets	1,298,206	27,106	4.21 %	1,019,839	21,971	4.34 %	
Cash and Due from Banks	28,916			18,647			
Other Assets	68,297			34,268			
Total Assets	\$ 1,395,546			\$ 1,072,754			
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b>							
Interest-bearing Demand	\$ 360,768	1,020	0.57 %	\$ 329,617	570	0.35 %	
Money Market	265,208	1,081	0.82 %	250,396	705	0.57 %	
Savings	170,589	150	0.18 %	62,455	18	0.06 %	
Time	215,651	1,526	1.43 %	188,988	1,188	1.27 %	
Total Interest-bearing Deposits	1,012,216	3,777	0.75 %	831,456	2,481	0.60 %	
Short-term Borrowings	1,518	12	1.59 %	2,256	13	1.16 %	
Long-term Debt	12,297	149	2.44 %	13,525	161	2.40 %	
Subordinated Debt	17,337	470	5.47 %	7,416	198	5.38 %	
Total Interest-bearing Liabilities	1,043,368	4,408	0.85 %	854,653	2,853	0.67 %	
Noninterest-bearing Demand	195,597			134,000			
Other Liabilities	13,472			11,492			
Shareholders' Equity	142,982			72,609			
Total Liabilities & Shareholders' Equity	\$ 1,395,546			\$ 1,072,754			
Net Interest Income (taxable equivalent basis)		\$ 22,698			\$ 19,118		
Taxable Equivalent Adjustment		(406 )			(533 )		
Net Interest Income		\$ 22,292			\$ 18,585		
Total Yield on Earning Assets			4.21 %			4.34 %	

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Rate on Supporting Liabilities	0.85 %	0.67 %
Average Interest Spread	3.36 %	3.67 %
Net Interest Margin	3.53 %	3.78 %

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of \$281,000 and \$299,000 for the six months ended June 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at June 30, 2018 and 2017, respectively.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of \$124,000 and \$234,000 for the six months ended June 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at June 30, 2018 and 2017, respectively.

42

---

## MID PENN BANCORP, INC.

(Dollars in thousands on a Taxable Equivalent Basis)	Six months ended June 30, 2018 vs. 2017		
	Increase (decrease)		
	Volume	Rate	Net
<b>INTEREST INCOME:</b>			
Interest Bearing Balances	\$5	\$14	\$19
<b>Investment Securities:</b>			
Taxable	476	205	681
Tax-Exempt	723	(261 )	462
Total Securities	1,199	(56 )	1,143
Federal Funds Sold	107	140	247
Loans and Leases, Net	3,825	(176 )	3,649
Restricted Investment Bank Stocks	8	69	77
Total Interest Income	5,144	(9 )	5,135
<b>INTEREST EXPENSE:</b>			
<b>Interest Bearing Deposits:</b>			
Interest Bearing Demand	54	396	450
Money Market	42	334	376
Savings	32	100	132
Time	168	170	338
Total Interest Bearing Deposits	296	1,000	1,296
Short-term Borrowings	(4 )	3	(1 )
Long-term Debt	(15 )	3	(12 )
Subordinated Debt	265	7	272
Total Interest Expense	542	1,013	1,555
<b>NET INTEREST INCOME</b>	<b>\$4,602</b>	<b>\$(1,022)</b>	<b>\$3,580</b>

During the six months ended June 30, 2018, taxable-equivalent net interest income increased \$3,580,000 or 19 percent to \$22,698,000 from \$19,118,000 during the six months ended June 30, 2017. Net interest income in the first half of 2018 was positively impacted by \$70,769,000 of loans and \$114,039,000 of investment securities acquired in the Scottsdale acquisition on January 8, 2018.

For the six months ended June 30, 2018, Mid Penn's tax-equivalent net interest margin was 3.53% compared to 3.78% for the six months ended June 30, 2017. The decrease in the net interest margin year over year was attributed to both an increase in the cost of funds and a lower yield earned on the loan portfolio. The cost of funds increased to 0.85% for the first half of 2018, versus 0.67% for the first half of 2017, primarily as a result of the impact of the FOMC rate increases in the past twelve months. For the six months ended June 30, 2018, the overall loan portfolio yield was 4.76%, compared to a loan portfolio yield of 4.79% for the same period in 2017. The loan yield for the first quarter of 2018 reflects the impact of Scottsdale loans acquired at fair value on January 8, 2018.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the interest-bearing product and pricing options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly change the estimates used in Mid Penn's asset and liability management and related interest rate risk simulation models. In addition, our net interest income may be impacted by further interest rate actions of FOMC.

Provision for Loan Losses

The provision for loan and lease losses is the expense necessary to maintain the allowance at a level adequate to absorb management's estimate of probable losses in the loan and lease portfolio. Mid Penn's provision for loan and lease losses is based upon management's monthly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans and leases, analyze delinquencies, ascertain loan and lease growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets Mid Penn serves.

Mid Penn has maintained the allowance in accordance with Mid Penn's assessment process, which takes into consideration, among other relevant factors, the risk characteristics of the loan portfolio, the growth in the loan portfolio during the first six months of 2018, and shifting collateral values from December 31, 2017 to June 30, 2018.

## MID PENN BANCORP, INC.

Management performs a monthly evaluation of the adequacy of the loan and lease loss allowance and based on this evaluation, no loan loss provision was recorded for the three months ended June 30, 2018, compared to a loan loss provision of \$100,000 for the three months ended June 30, 2017. During the six months ended June 30, 2018, the provision for loan and lease losses was \$125,000 compared to \$225,000 for the six months ended June 30, 2017. The amount of loan loss provision for the first six months of 2018 was less than the same period in 2017 as Mid Penn had net loan recoveries of \$458,000 in the first six months of 2018 which substantially increased the allowance for loan loss balance. The allowance for loan and lease losses as a percentage of total loans was 0.79% at June 30, 2018, compared to 0.84% at December 31, 2017, and 0.89% at June 30, 2017. This ratio reflects the impact of the entire portfolio of Scottdale loans being added at fair value with no accompanying loan and lease loss allowance in accordance with purchase accounting GAAP. For further discussion of factors affecting the provision for loan and lease losses please see Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses in the Financial Condition section of this Management's Discussion and Analysis.

## Noninterest Income

During the three months ended June 30, 2018, noninterest income was \$1,559,000 reflecting an increase of \$197,000 or 14 percent compared to noninterest income of \$1,362,000 for the three months ended June 30, 2017. For the six months ended June 30, 2018, noninterest income totaled \$3,206,000, an increase of \$408,000 or 15 percent, compared to noninterest income of \$2,798,000 for the same period in 2017.

The following components of noninterest income showed significant changes:

(Dollars in Thousands)	Three Months Ended June 30,			
	2018	2017	\$	%
			Variance	Variance
Income from fiduciary activities	\$286	\$200	\$ 86	43 %
Service charges on deposits	222	174	48	28 %
Net gain on sales of investment securities	4	12	(8 )	-67 %
Mortgage banking income	205	225	(20 )	-9 %
ATM debit card interchange income	326	232	94	41 %

(Dollars in Thousands)	Six Months Ended June 30,			
	2018	2017	\$	%
			Variance	Variance
Income from fiduciary activities	\$526	\$396	\$ 130	33 %
Service charges on deposits	425	379	46	12 %
Net gain on sales of investment securities	102	20	82	410 %
Mortgage banking income	361	416	(55 )	-13 %
ATM debit card interchange income	591	456	135	30 %
Other income	492	393	99	25 %

Income from fiduciary activities was \$526,000 for the six months ended June 30, 2018, an increase of \$130,000 or 33 percent compared to fiduciary income of \$396,000 for the six months ended June 30, 2017. These additional revenues were attributed to continued growth in trust assets under management as a result of successful business development efforts by Mid Penn's wealth management team.

For the six months ended June 30, 2018, service charges on deposits were \$425,000, an increase of \$46,000 or 12 percent, compared to service charges of \$379,000 for the six months ended June 30, 2017. This increase was driven by an increase in the volume of transactional deposit accounts, including acquired deposit accounts from the Scottsdale acquisition, and an increase in charges collected.

Net gains on sales of securities were \$102,000 for the six months ended June 30, 2018, an increase of \$82,000 compared to net gains on sales of securities of \$20,000 during the same period of 2017. Some investment securities acquired from Scottsdale were subsequently sold to ensure the overall portfolio was in greater alignment with Mid Penn's investment management objectives.

ATM debit card interchange income was \$591,000 for the six months ended June 30, 2018, an increase of \$135,000 or 30 percent compared to interchange income of \$456,000 for the same period in 2017. The additional income is a result of an increased volume of checking accounts, and an increase in Mid Penn Bank ATM and debit card activity, which included an increase in transaction volume resulting from accounts added from the Scottsdale acquisition.

Other income was \$492,000 for the six months ended June 30, 2018, an increase of \$99,000 or 25 percent compared to other income of \$393,000 for the same period of 2017. The increase in other income was primarily driven by increases in letter of credit renewal fees and other service fees.

Mortgage banking income was \$361,000 for the six months ended June 30, 2018, a decrease of \$55,000 or 13 percent compared to the six months ended June 30, 2017. Rising longer-term interest rates have resulted in a lower volume of mortgage refinance activity in the first half of 2018 when compared to the same period in 2017.



## MID PENN BANCORP, INC.

## Noninterest Expense

During the three months ended June 30, 2018, noninterest expenses totaled \$9,742,000, an increase of \$2,184,000 or 29 percent compared to noninterest expenses of \$7,558,000 for the three months ended June 30, 2017. Noninterest expense for the six months ended June 30, 2018 totaled \$20,925,000, an increase of \$5,565,000 or 36 percent compared to noninterest expenses of \$15,360,000 for the first six months of 2017.

The changes were primarily a result of the following components of noninterest expense, which had notable variances when comparing results for periods ending in 2018 versus the similar period in 2017:

(Dollars in Thousands)	Three Months Ended June 30,				
	2018	2017	\$ Variance	% Variance	
Salaries and employee benefits	\$4,542	\$4,159	\$ 383	9	%
Occupancy expense, net	870	593	277	47	%
Equipment expense	544	370	174	47	%
FDIC Assessment	93	194	(101 )	-52	%
Legal and professional fees	256	189	67	35	%
Marketing and advertising expense	230	131	99	76	%
Software licensing	512	370	142	38	%
Telephone expense	156	133	23	17	%
Intangible amortization	248	24	224	933	%
Merger and acquisition expense	222	14	208	1486	%
Other expenses	1,897	1,215	682	56	%

(Dollars in Thousands)	Six Months Ended June 30,				
	2018	2017	\$ Variance	% Variance	
Salaries and employee benefits	\$9,606	\$8,389	\$ 1,217	15	%
Occupancy expense, net	1,667	1,241	426	34	%
Equipment expense	952	751	201	27	%
FDIC Assessment	321	388	(67 )	-17	%
Legal and professional fees	480	366	114	31	%
Marketing and advertising expense	419	238	181	76	%
Software licensing	1,026	699	327	47	%
Telephone expense	303	259	44	17	%
Intangible amortization	496	53	443	836	%
Merger and acquisition expense	1,916	224	1,692	755	%
Other expenses	3,394	2,334	1,060	45	%

During the first half of 2018, merger and acquisition expenses of \$1,916,000 were incurred in connection with (i) the completed acquisition of Scottdale on January 8, 2018 and the subsequent systems conversion activities, with such expenses including severance costs, legal and professional fees, investment banking fees, and information technology

costs; and (ii) the planned acquisition of First Priority, with such expenses including primarily investment banking fees, merger-related legal expenses, and professional fees related to the preparation and filing of merger documents. Merger and acquisition expenses of \$224,000 recorded during the first half of 2017 were investment banking and legal fees related to the initial stages of the Scottsdale acquisition.

Salaries and employee benefits expense increased \$1,217,000 or 15 percent during the six months ended June 30, 2018, versus the same period in 2017, with the increase attributable to (i) the retail staff additions at the five retail locations added through the Scottsdale acquisition and the opening of the Halifax, PA branch, all effective January 8, 2018, and (ii) the addition of commercial lending personnel and credit support staff in alignment with Mid Penn's core banking growth.

Occupancy expenses increased \$426,000 or 34 percent during the first six months of 2018 compared to the same period in 2017. Similarly, equipment expense increased \$201,000 or 27 percent during the first six months of 2018 compared to the first six months of 2017. These increases were driven by (i) the facility operating costs and increased depreciation expense for building, furniture, and equipment associated with the addition of the above-noted Scottsdale market and Halifax, PA branch offices, and (ii) depreciation and occupancy costs related to Mid Penn's move to new administrative facilities in the Capital Region.

FDIC assessment expense was \$321,000 for the six months ended June 30, 2018, a decrease of \$67,000 or 17 percent compared to \$388,000 for the six months ended June 30, 2017. As a result of the Scottsdale acquisition and successful workouts of non-performing assets, Mid Penn has reported more favorable capital and asset quality ratios, resulting in a lower FDIC Assessment rate for the second quarter of 2018.

Legal and professional fees for the six months ended June 30, 2018 increased by \$114,000 or 31 percent compared to the same period in 2017 due to increased third-party services for wealth management, audit, and public relations activities.

MID PENN BANCORP, INC.

Marketing and advertising expense increased 76 percent, from \$238,000 for the six months ended June 30, 2017 to \$419,000 for the same period in 2018. The increased costs were a result of increased marketing and branding initiatives related to the Scottdale acquisition, and market-specific business development promotions across Mid Penn's footprint.

Software licensing costs were \$1,026,000 during the six months ended June 30, 2018, an increase of \$327,000 or 47 percent compared to \$699,000 for the six months ended June 30, 2017. The increase is a result of additional costs to license all the Scottdale locations and new branches, upgrades to internal systems to enhance data management and storage capabilities given the larger company profile, and increases in certain core processing fees as our customer base and transaction volume continues to grow.

Intangible amortization increased from \$53,000 during the six months ended June 30, 2017 to \$496,000 during the same period in 2018. As a result of the Scottdale acquisition, Mid Penn added a core deposit intangible (CDI) asset of \$4,940,000 which will amortize using the sum of the years' digit method over a ten year period. The resulting additional amortization recorded during the first half of 2018, related to the Scottdale CDI, was \$449,000.

Other expense was \$3,394,000 during the six months ended June 30, 2018, an increase of \$1,060,000 or 45 percent compared to other expense of \$2,334,000 for the same period in 2017. Several categories within other expense drove this overall increase, including but not limited to: (i) increases to stationary and supplies, printing, postage, and insurance costs as a result of additional branches added since June 30, 2017; (ii) increased loan collection costs and foreclosed real estate expenses; and (iii) higher subscription, travel and lodging, and employee relations costs, as both the Scottdale acquisition and organic growth have increased the organization's geographic profile and employee base.

#### Income Taxes

The provision for income taxes was \$452,000 for the three months ended June 30, 2018 compared to \$769,000 for the three months ended June 30, 2017. The effective tax rate for the three months ended June 30, 2018 was 14.0 percent compared to 24.7 percent for the three months ended June 30, 2017. The provision for income taxes was \$665,000 for the six months ended June 30, 2018 compared to \$1,459,000 for the six months ended June 30, 2017. The effective tax rate for the six months ended June 30, 2018 was 15.0 percent compared to 25.2 percent for the six months ended June 30, 2017. The decrease in the provision for income taxes was largely driven by the decrease in the statutory tax rate from 34 percent to 21 percent as a result of the Tax Cuts and Jobs Act enacted December 22, 2017. The statutory rate change was effective January 1, 2018. Contributing to the decrease in the provision for income taxes was a one-time income tax benefit of \$92,000 recorded in the second quarter of 2018 as a result of amended 2014 through 2016 tax returns, as corrected K-1 statements were received related to Mid Penn's investment in a limited partnership which provides low-income housing in Enola, Pennsylvania.

Generally, Mid Penn's effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and BOLI, as well as the impact of tax credits. The realization of Mid Penn's deferred tax assets is dependent on future earnings. Mid Penn currently anticipates that future earnings will be adequate to fully realize the currently recorded deferred tax assets.

## Financial Condition

## Overview

Mid Penn's total assets were \$1,415,647,000 as of June 30, 2018, an increase of \$245,293,000 or 21 percent compared to total assets of \$1,170,354,000 as of December 31, 2017. Asset growth during the first half of 2018 includes the acquired loans, investments, cash, facilities, goodwill and core deposit intangible recorded from the legal closing of the Scottsdale transaction.

## Loans

Total loans at June 30, 2018 were \$1,036,479,000 compared to \$910,404,000 at December 31, 2017, an increase of \$126,075,000 or over 13 percent since year-end 2017. As a result of the Scottsdale acquisition, on January 8, 2018, Mid Penn added to its loan portfolio, primarily within the residential mortgage and commercial real estate mortgage categories. As of June 30, 2018, the outstanding balance of Scottsdale acquired loans was \$65,231,000. The majority of Mid Penn's organic loan growth in legacy markets continues to be commercial loans, including both commercial and industrial financing, and commercial real estate credits.

(Dollars in thousands)	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Commercial and industrial	\$204,724	19.8 %	\$188,033	20.7 %
Commercial real estate	575,956	55.6 %	515,012	56.6 %
Commercial real estate - construction	82,690	8.0 %	62,336	6.8 %
Lease financing	153	0.0 %	229	0.0 %
Residential mortgage	120,260	11.6 %	99,033	10.9 %
Home equity	47,815	4.6 %	41,893	4.6 %
Consumer	4,881	0.5 %	3,868	0.3 %
	\$1,036,479	100.0 %	\$910,404	100.0 %

## MID PENN BANCORP, INC.

## Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses

For the six months ended June 30, 2018, Mid Penn had net recoveries of \$458,000 compared to net recoveries of \$305,000 during the same period of 2017. The primary reason for this favorable net recovery amount was that, during the second quarter of 2018, Mid Penn recovered \$777,000 of principal from the successful workout of a commercial real estate relationship that originally had a partial charge-off in 2009. Similarly, during the first quarter of 2017, Mid Penn recovered \$318,000 of principal, as well as collected \$279,000 in interest income, from the successful workout of a commercial real estate relationship that was partially charged-off in 2010.

Loans charged off during the first six months of 2018 totaled \$351,000 and included two home equity loans for \$167,000, one commercial and industrial loan for \$129,000, one commercial real estate (construction) loan for \$40,000, one residential mortgage loan for \$5,000, one consumer loan for \$3,000, and \$7,000 in deposit account charge-offs. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses if economic conditions or loan credit quality differs substantially from the assumptions used in making Mid Penn's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

Changes in the allowance for the six months ended June 30, 2018 and 2017 are summarized as follows:

(Dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Balance, beginning of period	\$7,606	\$7,183
Loans charged off during period	(351 )	(76 )
Recoveries of loans previously charged off	809	381
Net recoveries	458	305
Provision for loan and lease losses	125	225
Balance, end of period	\$8,189	\$7,713
Ratio of net loans recovered to average loans outstanding, annualized	-0.09 %	-0.07 %
Ratio of allowance for loan losses to net loans at end of period	0.79 %	0.89 %

Other than as described herein, Mid Penn does not believe there are any trends or events at this time that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Further, based on known information, Mid Penn believes that the effects of current and past economic conditions and other unfavorable business conditions may influence certain borrowers' abilities to comply with their repayment terms. Mid Penn continues to monitor closely the financial strength of these borrowers. Mid Penn does not engage in practices which may be used to artificially shield certain borrowers from the negative economic or business cycle effects that may compromise their ability to repay. Mid Penn does not normally structure construction loans with interest reserve components. Mid Penn has not in the past performed any commercial real estate or other type of loan workouts whereby an existing loan was restructured into multiple new loans. Also, Mid Penn does not extend loans at maturity solely due to the existence of guarantees, without recognizing the credit as impaired. While the existence of a guarantee may be a mitigating factor in determining the proper level of allowance once impairment has been

identified, the guarantee does not affect the impairment analysis.

47

---

## MID PENN BANCORP, INC.

The following table presents the change in nonperforming asset categories as of June 30, 2018, December 31, 2017, and June 30, 2017.

(Dollars in thousands)

	June 30, 2018	December 31, 2017	June 30, 2017
<b>Nonperforming Assets:</b>			
Nonaccrual loans	\$8,612	\$ 10,575	\$5,218
Accruing troubled debt restructured loans	531	544	557
Total nonperforming loans	9,143	11,119	5,775
Foreclosed real estate	912	189	-
Total non-performing assets	10,055	11,308	5,775
Accruing loans 90 days or more past due	-	-	57
Total risk elements	\$10,055	\$ 11,308	\$5,832
Nonperforming loans as a % of total			
loans outstanding	0.88 %	1.22 %	0.67 %
Nonperforming assets as a % of total			
loans outstanding and other real estate	0.97 %	1.24 %	0.67 %
Ratio of allowance for loan losses			
to nonperforming loans	89.57 %	68.41 %	133.56%

In the table above, troubled debt restructured loans that are no longer accruing interest are included in nonaccrual loans. The decrease in nonperforming assets is primarily due to (i) the successful workout of one nonaccrual loan relationship during the second quarter which decreased the total nonaccrual loan pool by \$1,094,000 and (ii) the sale of some collateral in an existing nonaccrual loan relationship resulting in total principal pay-down of \$1,393,000. Two loan relationships which account for \$5,746,000 of the non-performing loan balance are discussed in more detail below.

Loan relationship no. 1 – At June 30, 2018, the contractual outstanding principal balance of this loan relationship was \$4,410,000. A \$282,000 specific allowance allocation was assigned to this relationship. As part of the workout process, this loan was modified as a troubled debt restructured loan during 2017. Management is pursuing diligent workout efforts, including proceeds from the sale of pledged collateral not associated with the primary operation of the business, to restore the loan to current status and to collect the remaining outstanding balance.

Loan relationship no. 2 – At June 30, 2018, the contractual outstanding principal balance of this loan relationship was \$1,423,000 and was comprised of five loans collateralized primarily by commercial real estate, as well as certain

machinery and equipment. As part of the workout process, the loans in this relationship were modified as a troubled debt restructured loans during 2017. During the second quarter of 2018, collateral was sold resulting in the principal payoff of three loans within this loan relationship totaling \$1,393,000. Given that the fair value of the remaining collateral exceeds the outstanding principal balance, no specific allowance allocation has been assigned to this relationship. Management expects to recover the remaining outstanding balance through the sale of real estate collateral pledged in support of the loans.



## MID PENN BANCORP, INC.

Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact and is not treated as a restructured credit. The following table provides additional analysis of partially charged-off loans.

(Dollars in thousands)

	June 30, 2018	December 31, 2017		
Period ending total loans outstanding	\$ 1,036,479	\$ 910,404		
Allowance for loan and lease losses	8,189	7,606		
Total Nonperforming loans	9,143	11,119		
Nonperforming and impaired loans with partial charge-offs	315	1,701		
Ratio of nonperforming loans with partial charge-offs to total loans	0.03	%	0.19	%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	3.45	%	15.30	%
Coverage ratio net of nonperforming loans with partial charge-offs	92.76	%	80.76	%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	0.79	%	0.84	%

Mid Penn considers a commercial loan or commercial real estate loan to be impaired when it becomes 90 days or more past due and not well-secured or otherwise not probable for collection. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow method indicates no operating income is available for evaluating the collateral position; therefore, most impaired loans are deemed to be collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as nonaccrual or lower will first have a collateral evaluation completed in accordance with the guidance on impaired loans. Once the collateral evaluation has been completed, a specific allocation of allowance is made based upon the results of the evaluation. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variation in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the

evaluation. Consumer loans are recommended for charge-off after reaching delinquency of 90 days and the loan is not well-secured or otherwise not probable for collection. The collateral shortfall of the consumer loan is recommended for charge-off at this point.

As noted above, Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan or commercial real estate loan becomes classified under its internal classification system. A preliminary collateral evaluation in accordance with the guidance on impaired loans is prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary, but allows Mid Penn to determine if any potential collateral shortfalls exist.

Larger groups of small-balance loans, such as residential mortgages and consumer installment loans are collectively evaluated for impairment. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures unless such loans are the subject of a restructuring agreement.

Mid Penn's rating system assumes any loans classified as substandard nonaccrual to be impaired, and most of these loans are considered collateral dependent; therefore, most of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as practically possible following the credit being classified as substandard nonaccrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however, no allowance recommendation will be made until such time Mid Penn is in receipt of the updated valuation. The Asset Recovery department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no material time lapses noted with the above processes.

MID PENN BANCORP, INC.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary.

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property as soon as practically possible of being placed on nonaccrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 12 months for possible revaluation by an independent third party.

Mid Penn had \$9,670,000 loans deemed impaired at June 30, 2018. Excluding \$1,982,000 in loans acquired with credit deterioration from the Phoenix Bancorp, Inc. ("Phoenix") and Scottsdale acquisitions, Mid Penn had several loan relationships deemed impaired with an aggregate carrying balance of \$7,688,000. This pool of loans was further broken down into a group of loans with an aggregate carrying balance of \$5,241,000 for which specific allocations totaling \$574,000 were included within the loan loss reserve for these loans. The remaining \$2,447,000 of loans required no specific allocation within the loan loss reserve. Of the \$7,688,000 of impaired loan relationships, excluding the loans acquired with credit deterioration from the Phoenix and Scottsdale acquisitions, \$4,324,000 were commercial and industrial relationships, \$2,261,000 were commercial real estate relationships, \$728,000 were residential relationships, \$367,000 were commercial real estate – construction relationships, and \$8,000 were home equity relationships. There were specific loan loss reserve allocations of \$282,000 against the commercial and industrial relationships, \$238,000 against the commercial real estate relationships, and \$54,000 against the commercial real estate – construction relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships.

The allowance is a reserve established in the form of a provision expense for loan and lease losses and is reduced by loan charge-offs net of recoveries. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risk on a monthly basis so that an appropriate allowance is maintained. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance to the Board of Directors, indicating any changes in the allowance since the last review. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance an integral part of the examination process. As part of the examination process, federal or state regulatory agencies may require Mid Penn to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

In establishing the allowance, management evaluates on a quantitative basis individual classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. In addition, an allowance for the remainder of the loan and lease portfolio is determined based on historical loss experience within certain components of the portfolio. These allocations may be modified if current conditions indicate that loan and lease losses may differ from historical experience.

In addition, a portion of the allowance is established for losses inherent in the loan and lease portfolio which have not been identified by the quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. These factors include:

- changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
- changes in the value of underlying collateral for collateral-dependent loans;
  - changes in the experience, ability, and depth of lending management and other relevant staff;
- changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- changes in the quality of the institution's loan review system;
- changes in the nature and volume of the portfolio and in the terms of loans;
- the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio; and
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

## MID PENN BANCORP, INC.

While the allowance is maintained at a level believed to be adequate by management to provide for probable losses inherent in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. The unallocated component of the allowance for loan and lease losses covers several considerations that are not specifically measurable through either the specific and general components. For example, we believe that we could face increasing credit risks and uncertainties, not yet reflected in recent historical losses or qualitative factor assessments, associated with unpredictable changes in economic growth or business conditions in our markets or for certain industries in which we have commercial loan borrowers, or unanticipated stresses to the values of real estate held as collateral. Any or all of these additional issues can adversely affect our borrowers' ability to timely repay their loans. Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, the unallocated component allocation recognizes the inherent imprecision in our allowance for loan and lease loss methodology, or any alternative methodology, for estimating specific and general loan losses, including the unpredictable timing and amounts of charge-offs, the fact that historical loss averages don't necessarily correlate to future loss trends, and unexpected changes to specific-credit or general portfolio future cash flows and collateral values which could negatively impact unimpaired portfolio loss factors. Changes from these various other uncertainties and considerations may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance of \$8,189,000 is adequate as of June 30, 2018 to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

### Liquidity

Mid Penn's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity provides resources for credit needs of borrowers, for depositor withdrawals, and for funding corporate operations. Sources of liquidity are as follows:

- a growing core deposit base;
- proceeds from the sale or maturity of investment securities;
- proceeds from interest-bearing time deposits with other financial institutions;
- payments received on loans and mortgage-backed securities;
- overnight correspondent bank borrowings on various credit lines; and
- borrowing capacity available from the FHLB, the Federal Reserve Discount Window, and other lines of credit currently available to Mid Penn.

The major sources of cash received in the first six months of 2018 came from the \$102,816,000 in proceeds from the sales of available-for-sale investment securities and the \$65,025,000 in net cash received from the acquisition of Scottsdale.

Major uses of cash in the first six months of 2018 were \$79,383,000 for investment purchases, \$55,732,000 to fund loan growth, and \$34,611,000 to pay down short-term borrowings.

Mid Penn believes its core deposits are generally stable even in periods of changing interest rates. Liquidity is measured and monitored daily, allowing management to better understand and react to balance sheet trends. These measurements indicate that liquidity generally remains stable and exceeds our minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events, or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

On a quarterly basis, a comprehensive liquidity analysis is reviewed by the Asset Liability Committee and Board of Directors. The analysis provides a summary of the current liquidity measurements, projections, and future liquidity positions given various levels of liquidity stress. Management also maintains a detailed Contingency Funding Plan designed to respond to overall stress in the financial condition of the banking industry or a liquidity problem specific to Mid Penn.

MID PENN BANCORP, INC.

## Subordinated Debt

### Subordinated Debt Issued December 2017

On December 19, 2017, Mid Penn entered into agreements with investors to purchase \$10,000,000 aggregate principal amount of its Subordinated Notes due 2028 (the “2017 Notes”). The 2017 Notes are intended to be treated as Tier 2 capital for regulatory capital purposes. The offering closed in December 2017.

The 2017 Notes bear interest at a rate of 5.25% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no times be less than 5.0%. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, beginning on July 15, 2018, for the first five years after issuance and will be payable quarterly in arrears thereafter on January 15, April 15, July 15, and October 15. The 2017 Notes will mature on January 1, 2028 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 21, 2022, and prior to January 1, 2028. Additionally, Mid Penn may redeem the 2017 Notes in whole at any time, or in part from time to time, upon at least 30 days’ notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2017 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2017 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended. In the event of a redemption described in the previous sentence, Mid Penn will redeem the 2017 Notes at 100% of the principal amount of the 2017 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the 2017 Notes may not accelerate the maturity of the 2017 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar event of Mid Penn or Mid Penn Bank, its principal banking subsidiary.

### Subordinated Debt Issued December 2015

On December 9, 2015, Mid Penn sold \$7,500,000 aggregate principal amount of Subordinated Debt (the “2015 Notes”) due 2025. The 2015 Notes are treated as Tier 2 capital for regulatory capital purposes.

The 2015 Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The 2015 Notes will mature on December 9, 2025 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 9, 2020, and prior to December 9, 2025. Additionally, Mid Penn may redeem the 2015 Notes in whole at any time, or in part from time to time, upon at least 30 days’ notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2015 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2015 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended, in each case at 100% of the principal amount of the 2015 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the 2015 Notes may not accelerate the maturity of the 2015 Notes, except upon Mid Penn’s or Mid Penn Bank’s bankruptcy, insolvency, liquidation, receivership or similar event.

## Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2016. The final rules implemented higher minimum capital requirements, added a new common equity Tier 1 capital requirement, and established criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity Tier 1 capital above its minimum risk-based capital requirements, which amount (when fully phased in) must be greater than 2.5% of total risk-weighted assets at January 1, 2019. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016 at the initial rate of 0.625%. A summary of the payout restrictions based on the capital conservation buffer is as follows:

	Maximum Payout
Capital Conservation Buffer (as a % of risk-weighted assets)	(as a % of eligible retained income)
> 2.5%	No payout limitation applies
≤2.5% and >1.875%	60%
≤1.875% and >1.25%	40%
≤1.25% and >0.625%	20%
≤0.625%	0%



## MID PENN BANCORP, INC.

Implementation of the deductions and other adjustments to common equity Tier 1 capital began on January 1, 2016 and will be phased-in over a three-year period. The final rules called for the following minimum capital requirements to be considered “well-capitalized” (which include the impact of the capital conservation buffer that was effective January 1, 2016):

	As of January 1,			
	2016	2017	2018	2019
Minimum common equity Tier 1 capital ratio	4.5 %	4.5 %	4.5 %	4.5 %
Common equity Tier 1 capital conservation buffer	0.625 %	1.25 %	1.875 %	2.5 %
Minimum common equity Tier 1 capital ratio plus capital conservation buffer	5.125 %	5.75 %	6.375 %	7.0 %
Phase-in of most deductions from common equity Tier 1 capital	60 %	80 %	100 %	100 %
Minimum Tier 1 capital ratio	6.0 %	6.0 %	6.0 %	6.0 %
Minimum Tier 1 capital ratio plus capital conservation buffer	6.625 %	7.25 %	7.875 %	8.5 %
Minimum total capital ratio	8.0 %	8.0 %	8.0 %	8.0 %
Minimum total capital ratio plus capital conservation buffer	8.625 %	9.25 %	9.875 %	10.5 %

The final rules allowed community banks to make a one-time election not to include the additional components of accumulated other comprehensive income (“AOCI”) in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. Mid Penn made the election not to include the additional components of AOCI in regulatory capital.

The final rules permanently grandfathered non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010 for inclusion in the Tier 1 capital of banking organizations with total consolidated assets less than \$15 billion as of December 31, 2009 and banking organizations that were mutual holding companies as of May 19, 2010.

Consistent with the Dodd-Frank Act, the new rules replaced the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-ups approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250% risk weight.

Under the new rules, mortgage servicing assets (“MSAs”) and certain deferred tax assets (“DTAs”) are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past-due loans, certain risk weights and credit conversion factors.

Mid Penn has implemented these changes in determining and reporting the regulatory ratios of Mid Penn and the Bank, and has concluded that the new rules do not have a material adverse effect on Mid Penn’s financial condition.

### Capital Resources

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The greater a corporation’s capital resources, the more likely it is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the corporation’s earnings have been invested in the continued growth of the business or paid to shareholders. An excess capital position may make it difficult for a

corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy and capital management have been, and will continue to be, of paramount importance.

Shareholders' equity increased by \$66,072,000 or 87 percent, from \$75,703,000 at December 31, 2017 to \$141,775,000 at June 30, 2018. The increase during the six months ended June 30, 2018 was attributed to (i) the issuance of 1,878,827 shares of Mid Penn common stock in connection with the acquisition of Scottsdale, and (ii) growth in retained earnings through year-to-date net income. These increases were partially offset by other comprehensive losses primarily due to the after-tax impact of the overall net unrealized decline in fair value of the available-for-sale investment portfolio since December 31, 2017. Regulatory capital ratios for both Mid Penn and the Bank exceeded regulatory "well-capitalized" levels at both June 30, 2018 and 2017.

Banks are evaluated for capital adequacy based on the ratio of capital to risk-weighted assets and total assets. The minimum capital to risk-weighted assets requirements, including the capital conservation buffers, which became effective for Mid Penn and the Bank on January 1, 2016 are illustrated below. At June 30, 2018, regulatory capital ratios for both Mid Penn and the Bank met the definition of a "well-capitalized" institution under the regulatory framework for prompt corrective action, and exceeded the minimum capital requirements under Basel III.

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

MID PENN BANCORP, INC.

Mid Penn and Mid Penn Bank maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios as of June 30, 2018 and December 31, 2017:

(Dollars in thousands)	Capital Adequacy				To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Actual: Amount	Ratio	Required (1): Amount	Ratio	Amount	Ratio
<b>Corporation</b>						
As of June 30, 2018:						
Tier 1 Capital (to Average Assets)	\$117,137	8.4 %	\$55,582	4.000%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	117,137	11.4 %	65,734	6.375%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	117,137	11.4 %	81,201	7.875%	N/A	N/A
Total Capital (to Risk Weighted Assets)	142,776	13.8 %	101,823	9.875%	N/A	N/A
<b>Bank</b>						
As of June 30, 2018:						
Tier 1 Capital (to Average Assets)	\$132,632	9.5 %	\$55,567	4.000%	\$69,458	5.0 %
Common Equity Tier 1 Capital (to Risk Weighted Assets)	132,632	12.9 %	65,723	6.375%	67,012	6.5 %
Tier 1 Capital (to Risk Weighted Assets)	132,632	12.9 %	81,187	7.875%	82,476	8.0 %
Total Capital (to Risk Weighted Assets)	140,929	13.7 %	101,806	9.875%	103,095	10.0 %
<b>Corporation</b>						
As of December 31, 2017:						
Tier 1 Capital (to Average Assets)	\$74,417	6.5 %	\$45,857	4.000%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	74,417	8.4 %	50,661	5.750%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	74,417	8.4 %	6,377	7.250%	N/A	N/A
Total Capital (to Risk Weighted Assets)	99,466	11.3 %	81,498	9.250%	N/A	N/A
<b>Bank</b>						
As of December 31, 2017:						
Tier 1 Capital (to Average Assets)	\$88,294	7.7 %	\$45,846	4.000%	\$57,308	5.0 %
Common Equity Tier 1 Capital (to Risk Weighted Assets)	88,294	10.0 %	50,661	5.750%	57,269	6.5 %
Tier 1 Capital (to Risk Weighted Assets)	88,294	10.0 %	63,877	7.250%	70,485	8.0 %
Total Capital (to Risk Weighted Assets)	96,005	10.9 %	81,498	9.250%	88,106	10.0 %

(1) The minimum amounts and ratios as of June 30, 2018 include the third year phase in of the capital conservation buffer of 1.875% required by the Basel III framework. At December 31, 2017, the minimum amounts and ratios included the second year phase in of the capital conservation buffer of 1.25 percent required by the Basel III framework.



MID PENN BANCORP, INC.

## ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a financial institution, Mid Penn's primary source of market risk is interest rate risk. Interest rate risk is the exposure to fluctuations in Mid Penn's future earnings (earnings at risk) resulting from changes in interest rates. This exposure or sensitivity is a function of the repricing characteristics of Mid Penn's portfolio of assets and liabilities. Each asset and liability reprices either at maturity or during the life of the instrument. Interest rate sensitivity is measured as the difference between the volume of assets and liabilities that are subject to repricing in a future period of time.

The principal purpose of asset-liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is increased by increasing the net interest margin and by volume growth. Thus, the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

Mid Penn utilizes an asset-liability management model to measure the impact of interest rate movements on its interest rate sensitivity position. Mid Penn's management also reviews the traditional maturity gap analysis regularly. Mid Penn does not always attempt to achieve an exact match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of Mid Penn's profitability.

Modeling techniques and simulation analysis involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of Mid Penn's interest rate risk position over time.

Management reviews interest rate risk on a quarterly basis. This analysis includes earnings scenarios whereby interest rates are increased and decreased by 100, 200, and 300 basis points. These scenarios, detailed in the table below, indicate that Mid Penn would experience enhanced net interest income over a one-year time frame due to upward interest rate changes, while a reduction in interest rates would result in a decline in net interest income over a one-year time frame; however, actual results could vary significantly from the calculations prepared by management. At June 30, 2018, all interest rate risk levels according to the model were within the tolerance limits of the Board-approved policy.

June 30, 2018			December 31, 2017		
	%			%	
	Change			Change	
	in			in	
	Net			Net	
Change in	Interest	Policy	Change in	Interest	Policy
Basis Points	Income	Risk Limit	Basis Points	Income	Risk Limit
300	10.09%	≥ -20%	300	7.83%	≥ -20%
200	6.69%	≥ -15%	200	5.12%	≥ -15%
100	3.30%	≥ -10%	100	2.41%	≥ -10%

0			0		
(100)	-2.84%	≥ -10%	(100)	-1.49%	≥ -10%
(200)	-7.65%	≥ -15%	(200)	-6.19%	≥ -15%
(300)	-12.71%	≥ -20%	(300)	-11.37%	≥ -20%

ITEM 4 – CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that Mid Penn files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of June 30, 2018, Mid Penn’s management, with the participation of the Principal Executive Officer and Principal Financial Officer, concluded that the disclosure controls and procedures were effective as of such date.

Changes in Internal Controls

During the three and six months ended June 30, 2018, there were no changes in Mid Penn’s internal control over financial reporting that have materially affected, or are reasonable likely to materially affect, Mid Penn’s internal control over financial reporting.

MID PENN BANCORP, INC.

## PART II – OTHER INFORMATION

### ITEM 1 – LEGAL PROCEEDINGS

Information regarding legal proceedings is included in Note 14, Subsequent Events, Litigation, under Part I, Item 1, Notes to Consolidated Financial Statements (Unaudited) and incorporated herein by reference. At the time and based on information currently available, management is not aware of any litigation that would reasonably be expected to have a material adverse effect on the consolidated financial position of Mid Penn or its subsidiaries taken as a whole. In addition, management does not know of any material proceedings contemplated by governmental authorities against Mid Penn or any of its properties.

### ITEM 1A – RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, to determine if there were material changes applicable to the six months ended June 30, 2018. In addition to the risk factors previously disclosed in the Annual Report on Form 10-K, investors should consider the following:

Mid Penn may be unable to successfully integrate First Priority's operations and retain First Priority's employees.

The merger acquisition of First Priority involves the integration of two companies that have previously operated independently. The difficulties of combining the operations of the two companies include, among other things: integrating personnel with diverse business backgrounds; combining different corporate cultures; and retaining key employees.

The process of integrating operations could cause an interruption of, or loss of momentum in, the activities of the business and the loss of key personnel. The integration of the two companies will require the experience and expertise of certain key employees of First Priority who are expected to be retained by Mid Penn. Mid Penn may not be successful in retaining these employees for the time period necessary to successfully integrate First Priority's operations with those of Mid Penn. The diversion of management's attention and any delays or difficulties encountered in connection with the merger and the integration of the two companies' operations could have an adverse effect on the business and results of operations of Mid Penn following the merger.

Additionally, Mid Penn may not be able to successfully achieve the level of cost savings and other synergies that it expects, and may not be able to capitalize upon the existing customer relationships of First Priority to the extent anticipated, or it may take longer, or be more difficult or expensive than expected to achieve these goals. This could have an adverse effect on Mid Penn's business, results of operation and stock price.

The recently completed First Priority and Scottdale acquisitions may increase the risks associated with each of these mergers, as well as place a strain on Mid Penn's financial and personnel resources that could adversely impact Mid Penn's business.

On January 8, 2018, Mid Penn completed its acquisition of Scottdale and on July 31, 2018, Mid Penn completed its acquisition of First Priority. The recent completion mergers will cause Mid Penn to continue to incur significant expenditures and will require substantial attention and effort from Mid Penn's management and other personnel. Mid Penn's current and planned operations, personnel, facility size and configuration, systems and internal procedures and

controls might be inefficient or inadequate to support these efforts at the same time. The increased risks and obligations associated with the mergers could place a strain on Mid Penn's financial position and personnel resources, which may adversely affect Mid Penn's stock price, revenues, results of operations and/or financial condition.

We may fail to realize all of the anticipated benefits of the First Priority merger.

The success of the First Priority merger will depend, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses of Mid Penn and First Priority. However, to realize these anticipated benefits and cost savings, which include increased Mid Penn lending limits and access to stable core deposits, we must successfully combine the businesses of Mid Penn and First Priority. If we are not able to achieve these objectives, the anticipated benefits and cost savings of the merger may not be realized fully or at all, or may take longer to realize than expected.

Another expected benefit from the merger is an expected increase in the revenues of the combined company from anticipated sales of Mid Penn's greater variety of financial products, and from increased lending out of Mid Penn's substantially larger capital base, to former First Priority customers and to new customers in First Priority's market area who may be attracted by the combined company's enhanced offerings. An inability to successfully market Mid Penn's products to First Priority's customer base could cause the earnings of the combined company to be less than anticipated.

Unanticipated costs relating to the First Priority merger could reduce Mid Penn's future earnings per share.

Mid Penn believes that it has reasonably estimated the likely incremental costs of the combined operations of Mid Penn and First Priority following the merger. However, it is possible that unexpected transaction costs such as taxes, fees or professional expenses or unexpected future operating expenses such as unanticipated costs to integrate the two businesses, increased personnel costs or increased taxes, as well as other types of unanticipated adverse developments, including negative changes in the value of the legacy First Priority loan portfolio, could have a material adverse effect on the results of operations and financial condition of Mid Penn following the merger. In addition, if actual costs are materially different than expected costs, the merger could have a significant dilutive effect on Mid Penn's earnings per share.



MID PENN BANCORP, INC.

Pending litigation relating to the merger could require us to incur significant costs and suffer management distraction.

Mid Penn is not currently able to predict the outcome of any suit arising out of or relating to the First Priority merger that is currently pending or may be filed in the future.

Mid Penn is currently, and could be subject to additional, demands or litigation related to the merger. Such actions may create additional uncertainty relating to the merger, and responding to such demands and defending such actions may be costly and distracting to management. Although there can be no assurance as to the ultimate outcome of any pending or threatened demand or litigation related to the First Priority merger, based on information available to Mid Penn management at this time, Mid Penn believes that the resolution of such demands or litigation will not have a material adverse effect on its respective financial position, results of operations or cash flows.

For additional information regarding pending litigation related to the First Priority merger, refer to Note 14, Subsequent Events, Litigation, under Part I, Item 1, Notes to Consolidated Financial Statements (Unaudited) included in this filing.

#### ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

#### ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

#### ITEM 4 – MINE SAFETY DISCLOSURES

Not Applicable

#### ITEM 5 – OTHER INFORMATION

None

#### ITEM 6 – EXHIBITS

Exhibit 3(i) – The Registrant’s amended Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to Registrant’s Registration Statement on Form S-4 (File No. 333-199740) filed with the SEC on October 31, 2014.)

Exhibit 3(ii) – The Registrant’s By-laws (Incorporated by reference to Exhibit 3(ii) to Registrant’s Current Report on Form 8-K filed with the SEC on August 30, 2010.)

Exhibit 11 – Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part I Item 1 of this Quarterly Report on Form 10-Q.)

Exhibit 31.1 – Certification of Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 - Certification of Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32 – Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS – XBRL Instance Document

Exhibit 101.SCH – XBRL Taxonomy Extension Schema

✿Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase

✿Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase

✿Exhibit 101.LAB – XBRL Taxonomy Extension Label Linkbase

✿Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase

MID PENN BANCORP, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Mid Penn Bancorp, Inc.

(Registrant)

By: /s/ Rory G. Ritrievi  
Rory G. Ritrievi  
President and CEO  
(Principal Executive Officer)

Date: August 7, 2018

By: /s/ Michael D. Peduzzi, CPA  
Michael D. Peduzzi, CPA  
Chief Financial Officer

Date: August 7, 2018